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No. 73-197

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

ROBERT R. FRANK, JACK H. STEIN, JOHN W. ROBERTS, JR., individually and as purported trustees under a Voting Trust Agreement dated June 2, 1969, relating to the issued shares of INDUSTRIAL GUARANTY BANCORP, a Florida corporation, and INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Petitioners,

vs.

J. WILLIAM WOLF and PEARL M. WOLF, individually and derivatively for the shareholders of INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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NO. _____

Supreme Court of the United States

OCTOBER TERM, 1972

ROBERT R. FRANK, JACK H. STEIN, JOHN W. ROBERTS, JR., individually and as purported trustees under a Voting Trust Agreement, dated June 2, 1969, relating to the issued shares of INDUSTRIAL GUARANTY BANCORP, a Florida corporation, and INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Petitioners,

vs.

J. WILLIAM WOLF and PEARL M. WOLF, individually and derivatively for the shareholders of INDUSTRIAL GUARANTY BANCORP, a Florida corporation,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered on April 24, 1973.

CITATION TO OPINIONS BELOW

The United States District Court for the Southern District of Florida filed no opinion, but did enter its Findings of Fact and Conclusions of Law on March 27, 1972 [A. 64] and amendment thereto [A. 81]. It entered its Final Judgment on April 5, 1972 [A. 78].

The opinion of the Court of Appeals, which affirmed in part, reversed in part and remanded with instructions, dated April 24, 1973 [A. 1], is reported at 477 F.2d 467. The appellate court's denial of Petition for Rehearing and Petition for Rehearing En Banc is reported at ____ F.2d ____ [A. 29].

JURISDICTION

The judgment of the Court of Appeals (printed in the annexed Appendix [A. 25]), was entered on April 24, 1973. The Court of Appeals stayed its mandate to and including July 18, 1973 [A. 31], and further stayed its mandate to and including July 28, 1973 [A. 33]. The proceedings in the District Court had been superseded, the Petitioners having posted in accordance with court order a $600,000 supersedeas bond. Thus, the proceedings below have been stayed pending the filing of petition for writ of certiorari and final determination thereof by this Court.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

I.

THE PURPOSE OF THE SECURITIES ACT OF 1933,[1] THE SECURITIES EXCHANGE ACT OF 1934,[2] AND RULE 10b-5[3] WAS NOT TO GUARANTEE A PROFIT ON ILLEGAL SECURITY TRANSACTIONS TO A MARKET-MAKING DEALER WHO WAS AN INSIDER TIPSTER/TIPPEE IN CONNECTION WITH THE SALES OF SUCH SECURITIES.

II.

WHERE NO DIVERSITY OF CITIZENSHIP EXISTS AND THE AMOUNT IN CONTROVERSY IS BELOW THE JURISDICTIONAL LIMITS, AND THE PLAINTIFFS ELECT TO REJECT THE RELIEF AFFORDED BY THE FEDERAL STATUTES WHICH WERE ORIGINALLY USED TO INVOKE THE JURISDICTION OF THE FEDERAL COURT, A DISTRICT COURT MUST DISMISS THE MATTER SINCE IT IS DIVESTED OF JURISDICTION THEREOF.

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[1] **15 U.S.C. §§ 77a thru 77aa** [hereinafter referred to as the 1933 Act].

[2] **15 U.S.C. §§ 78a thru 78hh** [hereinafter referred to as the 1934 Act].

[3] Promulgated by the Securities and Exchange Commission, **17 CFR § 240.10b-5** [hereinafter referred to as SEC Rule 10b-5].

III.

NEITHER THE FEDERAL STATUTES NOR THE CONCEPT OF PENDENT JURISDICTION CREATES A BODY OF FEDERAL CORPORATION LAW, AND THEREFORE A DISTRICT COURT HAS NO JURISDICTION TO GRANT RELIEF UNDER SUCH A CONCEPT OF NONEXISTENT LAW, ESPECIALLY WHERE THE RELIEF GRANTED WAS NOT SOUGHT OR PRAYED FOR.

IV.

A DISTRICT COURT IN THE DISPOSITION OF ANY MATTER BEFORE IT IS REQUIRED BY LAW TO PRESERVE ITS INTEGRITY AND MUST RAISE SUA SPONTE THE DOCTRINE OF UNCLEAN HANDS AND/OR PARI DELICTO, TO PREVENT A SUITOR A RECOVERY WHERE HE HAS CONDUCTED HIMSELF IN SUCH A MANNER SO AS TO SHOCK THE MORAL SENSIBILITIES OF THE JUDGE.

V.

FEDERAL RULE OF CIVIL PROCEDURE 23.1[4] IS A RULE DEALING WITH A DISTRICT COURT'S JURISDICTION TO ENTERTAIN A DERIVATIVE ACTION, AND WHERE THE PARTIES SEEKING RELIEF HAVE FAILED TO PLEAD AND PROVE THAT THEY AS

[4]28 U.S.C., Rules of Civil Procedure.

PLAINTIFFS FAIRLY AND ADEQUATELY REPRESENT THE INTERESTS OF SHAREHOLDERS OR MEMBERS SIMILARLY SITUATED IN ENFORCING THE RIGHTS OF THE CORPORATION, THE ACTION MUST BE DISMISSED AS A MATTER OF LAW.

VI.

A DISTRICT COURT IS WITHOUT JURISDICTION TO GRANT RELIEF BEYOND THE LIMITATIONS EXPRESSED BY THE CONGRESS IN ITS ENACTMENT OF THE SECURITIES ACT OF 1933[5] AND THE SECURITIES EXCHANGE ACT OF 1934.[6]

VII.

A DISTRICT COURT'S JURISDICTION IS LIMITED BY THE SUBSTANTIVE PROVISIONS OF THE RESPECTIVE STATUTES OF LIMITATIONS ENACTED BY THE VARIOUS STATES[7] WHEREIN THE SAID COURTS PRESIDE.

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[5] 15 U.S.C. § 771.

[6] 15 U.S.C. § 78bb.

[7] 28 U.S.C. § 1652.

VIII.

THE CLEARLY ERRONEOUS DOCTRINE IN CONNECTION WITH APPELLATE REVIEW BY THE FEDERAL JUDICIARY IS NOT GOVERNED BY THE CONVICTION THAT THE WHOLE OF THE RECORD REFLECTS THE TRUTH AND RIGHT OF THE CASE, BUT UPON THE CONCEPT THAT WHEN THE ENTIRE RECORD AND EVIDENCE ARE READ THERE IS A CONVICTION THAT THE TRIAL COURT IN REACHING ITS RULING MADE A MISTAKE.

STATUTES, FEDERAL RULES OF CIVIL PROCEDURE, AND ADMINISTRATIVE REGULATIONS INVOLVED

Act of May 27, 1933, c. 38, Title I, § 5, 48 Stat. 77; June 6, 1934, c. 404, § 204, 48 Stat. 906; August 10, 1954, c. 667, Title I, § 7, 68 Stat. 684 [15 U.S.C. § 77e], provides:

> (a) Unless a registration statement is in effect as to security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any

means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportations or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

Act of May 27, 1933, c. 38, Title I, § 12, 48 Stat. 84; August 10, 1954, c. 667, Title I, § 9, 68 Stat. 686 [15 U.S.C. § 77l] provides:

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Act of June 6, 1934, c. 404, § 10, 48 Stat. 891 [15 U.S.C. § 78j] provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Act of June 6, 1934, c. 404, § 28, 48 Stat. 903 [15 U.S.C. § 78bb] provides:

> (a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this

chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

(b) Nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, or (3) with regard to the binding effect on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this chapter or the rules and regulations thereunder.

Act of June 25, 1948, c. 646, 62 Stat. 944 [28 U.S.C. § 1652] provides:

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Rule 23.1, Federal Rules of Civil Procedure, 28 U.S.C., provides:

DERIVATIVE ACTIONS BY SHAREHOLDERS

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Added Feb. 28, 1966, eff. July 1, 1966.

Rule 82, Federal Rules of Civil Procedure, 28 U.S.C. provides:

JURISDICTION AND VENUE UNAFFECTED

These rules shall not be construed to extend or limit the jurisdiction of the United States district courts or the venue of actions therein. An admirality or maritime claim within the meaning of Rule 9(h) shall not be treated as a civil action for the purposes of Title 28, U.S.C. §§ 1391-93.

As amended Dec. 29, 1948, eff. Oct. 20, 1949; Feb. 28, 1966, eff. July 1, 1966.

12 CFR § 221.4, Reg. § 221.4 of Regulation U, Federal Reserve System (Under § 7, Securities Exchange Act of 1934), provides:

Reg. § 221.4. Supplement. (a) *Maximum loan value of stocks.* For the purpose of § 221.1, the maximum loan value of any stock, whether or not registered on a national securities exchange, shall be 35 percent of its current market value, as determined by any reasonable method. [As amended effective June 8, 1968, 33 F. R. 8772; effective July 8, 1969, 34 F. R. 9207]

17 CFR § 240.10b-5 (1949) [SEC Rule 10b-5] provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instru-

mentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement or a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

F.S.A. § 517.21 provides:

(1) Every sale made in violation of any of the provisions of this chapter shall be voidable at the election of the purchaser; and the person making such sale and every director, officer or agent of or for the seller, if the director, officer or agent shall have personally participated or aided in any way in making the sale, shall be jointly and severally liable to the purchaser in an action at law in any court of competent jurisdiction upon tender of the securities sold or of the contract made, for the full amount paid by such purchaser, with interest, together with all taxable court costs and reasonable attorney's fees; provided, that no action shall be brought

for the recovery of the purchase price after two years from the date of such sale and provided further, that no purchaser otherwise entitled shall claim or have the benefit of this section who shall have refused or failed within thirty days from the date thereof to accept an offer in writing of the seller to take back the security in question and to refund the full amount paid by such purchaser, together with interest on such amount for the period from the date of payment by such purchaser down to the date of repayment, such interest to be computed:

(a) In case such securities consist of interest bearing obligations at the same rate as provided in such obligations; and

(b) In case such securities consist of other than interest bearing obligations at the rate of six per cent per annum; less, in every case, the amount of any income from said securities that may have been received by such purchaser.

(2) Any person having a right of action against a dealer or salesman under this section shall have a right of action under the bond provided in § 517.12.

STATEMENT

A. PROCEEDINGS IN THE TRIAL COURT

The parties will be referred to in their original capacity in the trial court.

The Plaintiffs below, J. WILLIAM WOLF and PEARL M. WOLF, husband and wife, must be considered as one individual party holding a common status as joint venturers in connection with the matters and things material to these proceedings,[8] and they in fact acted solely and exclusively through the husband, J. WILLIAM WOLF.

Mr. Wolf, a registered real estate broker, a onetime bank director, and a securities investor, some time in the middle of 1969 received a tip in connection with the organization of a bank holding company. The tip emanated from the Defendant STEIN. WOLF subsequently confirmed the tip through conversations with the Defendants, FRANK and ROBERTS.

The bank holding company was to be organized under the laws of the State of Florida and was to be limited to fifteen stockholders, all residents of the State of Florida, to wit, INDUSTRIAL GUARANTY BANCORP [hereinafter referred to as IGB]. The organizers intended to exempt the IGB securities.[9]

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[8]Paragraph 5 of the Second Amended Complaint alleges: "At all material times, plaintiff J. William Wolf was the agent of Pearl M. Wolf who was then his wife, acting within the scope of his authority." [A.] The evidence adduced before the District Court clearly shows that all purchases of securities involved in these proceedings emanated from a joint account maintained in the names of both Mr. and Mrs. Wolf. The original deposit in said account was the proceeds of a loan of $50,000 from a New Jersey bank. The evidence further reflected that all profits realized from the sale of the securities involved were deposited into said account, and all payments for purchases of the securities involved were made by withdrawals from this account.

[9]Exempt from registration under the Securities Act of 1933, 15 U.S.C. § 77c.

At this time WOLF maintained two residences, one in Broward County, Florida and one in New Jersey. During his discussions he left the impression with the Defendants that he was a Florida resident. In any event, he subscribed to the purchase of 37,500 shares at $2 per share directly from IGB. He did not pay for the subscription at that time, instead WOLF immediately commenced selling portions of it to third parties at prices in excess of $2 per share. In the early part of July 1969 the proceeds of such sales were deposited into a bank account maintained in the name of Plaintiff PEARL M. WOLF. In July 1969 both Plaintiffs borrowed $50,000 from a New Jersey bank[10] and deposited the loan proceeds into the joint bank account.

In the latter part of July 1969, WOLF forwarded the loan proceeds [$50,000] to IGB in payment of 25,000 shares of IGB stock. He made no indication of his resale of portions of his holdings and the entire 25,000 shares were registered in his name. WOLF continued to sell his IGB stock at prices in excess of $2 per share but did not advise IGB to reissue any shares in the names of his buyers.

In September 1969, WOLF forwarded an additional $12,500 to IGB in payment for 6,250 shares at $2 per share, and WOLF continued his sales of IGB stock.

On or about September 19, 1969, the individual Petitioners, with the consent or a majority of the Board of Directors of IGB, and 99% of its stockholders, exchanged their individual stock holdings in a national bank located

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[10]No compliance with Regulation U of the Federal Reserve Board. 12 C.F.R. 221.4, p. 12, *supra*.

in Miami, Florida, to wit: National Industrial Bank for IGB stock.

In October 1969 WOLF forwarded an additional $12,500 to IGB to pay for 6,250 shares at $2 per share. IGB, in accordace with WOLF's instructions, registered the September and October purchases either in WOLF's name or in MRS. WOLF's name.

IGB failed to obtain the hoped for exemption in accordance with the Act of 1933.[11]

On February 18, 1971 the proceedings in the trial court were commenced. An unverified Second Amended Complaint was filed on July 1, 1971 [A. 36], in three counts.

Count I charged IGB with misrepresentations, omissions, manipulative and deceptive devices, and the contrivance of a scheme and artifice to defraud the Respondents, in contravention of § 10(b) of the Act of 1934[12] and Rule 10b-5 promulgated and adopted by the Securities and Exchange Commission of the United States[13] [A. 47].

Count II charged IGB with violation of § 5 of the Act of 1933,[14] since IGB failed to register the securities with the SEC as required by § 5 of the 1933 Act.[15] [A. 47].

[11]Note 9, *supra*.

[12]15 U.S.C. § 78j(b), pg. 9, *supra*.

[13]Note 3, pg. 12, *supra*.

[14]15 U.S.C. § 77e; Note 8, pg. 6, *supra*.

[15]15 U.S.C. § 77e; Note 8, pg. 6, *supra*.

Count III charged that as a result of the fraudulent representations and omissions and acts of the corporate and individual Defendants, the Plaintiffs were damaged individually and derivatively, for a sum in excess of $10,000. Included in this particular Count was a charge of an intentional omission and false representation, attributable to the corporate and individual Defendants, to induce the Plaintiffs to purchase IGB stock [A. 48].

The Plaintiffs sought equitable relief, i.e., a preliminary and permanent injunction, the appointment of a receiver, an accounting, the imposition of a trust, and the impressment of an equitable lien, in order to secure any sums that may be due and owing to the Plaintiffs individually and derivatively. Further, the Plaintiffs sought the assessment of a sum in excess of $10,000 for compensatory damages, either individually or derivatively, as well as such other and further relief as may be deemed proper [A. 49].

The corporate and individual Defendants answered the Second Amended Complaint with general denials and affirmative defenses, which included allegations that the Plaintiffs resold their IGB stock at substantial profits, that the Plaintiffs suffered no loss, were in pari delicto and with unclean hands, and that the purpose of the lawsuit was to diminish the Plaintiffs' exposure to oral guarantees they had made to their customers who purchased IGB stock at prices higher than $2 per share; that the action was barred by the statute of limitations, and that the said Plaintiffs had not properly tendered for recission the IGB stock they still held, as required by the Act of 1933.[16] [A. 50]

[16]Note 5, pg. 8, *supra*.

The Defendants filed a Motion for Judgment on the Pleadings [A. 52], which the court treated as a motion for summary judgment, and dismissed the individual claim under § 12 of the Act of 1933.[17] The court further denied any derivative relief under the 1933 Act [A. 54].

The summary judgment did not disturb the Plaintiffs' individual claims under § 10 of the Act of 1934 and SEC Rule 10b-5.

On February 18, 1972 Plaintiffs filed an Amendment to the Second Amended Complaint by adding paragraph 32 to the **addendum clause** in which they sought and prayed for rescission of their purchase, i.e., to exchange the certificates still held for the purchase price paid therefor. [A. 59]

On March 8, 1972, the Defendant IGB filed its answer to the Amendment to Second Amended Complaint, and accepted the offer of rescission and tendered into the registry of the Court a $28,000 cashier's check made payable to the Clerk of the Court, representing the purchase price of the 14,000 shares still held by the Plaintiffs. [A. 60].

Trial was held before the Honorable C. Clyde Atkins, District Judge, without a jury. At the conclusion of the Plaintiffs' case the Plaintiffs' individual § 10 and 10b-5 claims were dismissed since they failed to show any actual damage.

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[17]Note 15, *supra*.

The court without any record to support it found that the § 10 and 10b-5 was properly filed.

The findings of the trial court are of interest since the court found as a matter of fact that the Plaintiffs violated the Act of 1933, and that they in fact had profited from said violations. [A. 54, 64, 67 and 82].

The court went on to find that the Plaintiffs established a derivative cause of action against the three individual Defendants in connection with the September 19, 1969 exchange of IGB stock for National Industrial Bank stock, and that there was no need to route the recovery to the minority shareholders. [A. 74][18]

The court denied punitive damages and intimated that the 10b-5 relief remedied the "state law claims"; and further ruled that the Plaintiffs could recover the $28,000 reposing in the Registry of the Court, if they so elected to rescind their purchase [15 U.S.C. § 771 and 15 U.S.C. 78bb, pg. 8 and 9].

On March 29, 1972 the Plaintiffs renounced their right to rescission [A. 77].

On April 5, 1972, Final Judgment was entered, awarding IGB (derivative Defendant/Plaintiff below) the

[18]Neither of the lower courts answered the riddle of the lack of jurisdiction. It was apparent early in the proceedings that the Plaintiffs could not recover individually in excess of $10,000 [compare their stock holdings of .0093% on a pro rata basis with the total derivative recovery]. As a matter of law they were not entitled to rescission since they had in fact profited. When the trial court seized upon the granting of relief in the nonprayed for diversity situation, the proper alignment of the parties plaintiff and defendant would have defeated the court's jurisdiction for lack of diversity [IGB, a Florida corporation, would have to be regarded as a plaintiff, see note 21, *infra*].

following recoveries from the Respondents, STEIN — $248,072.11; FRANK — $138,921.64; ROBERTS — $109,151.90.

In disposing of the Defendants' post-trial motions, the trial court denied Defendants' Motion for new trial, but granted Defendants' motion to amend the Findings of Fact and Conclusions of Law [A. 81]. Supersedeas was posted, and an appeal was prosecuted to the United States Court of Appeals for the Fifth Circuit.

B. PROCEEDINGS IN THE COURT OF APPEALS.

On April 24, 1973, the United States Court of Appeals for the Fifth Circuit entered its opinion, reported at 477 F.2d 467 [A. 1], and its judgment [A. 25], which affirmed in part and reversed in part the judgment of the District Court.

On May 16, 1973, the Court of Appeals disposed of some pending matters, including denial of reimbursement of costs sought by the Petitioners herein; denial of an allowance to Respondents' attorneys for reasonable fees in conjunction with some interlocutory matters lately pending in the Court of Appeals; however, it did direct the District Court to determine an amount of attorneys' fees incurred by the Respondents in prosecuting and defending the appeal and cross-appeal, as well as an allowance of expert witness fees and attorneys' fees in maintaining the derivative suit. [A. 27] All of said awards were to be disbursed by IGB [A. 28].

The court of appeals stayed it's mandate to July 28, 1973 [A. 3[illegible]].

REASONS FOR GRANTING THE WRIT

It is evident that the federal judiciary has been called upon from time to time to invoke its jurisdiction in time-consuming class and derivative actions involving security transactions. In these instances there has been a constant expansion of federal jurisdiction to areas never intended to be covered by the Congress when the Acts of 1933 and 1934 were enacted.

The various Circuit Courts of Appeals have approved this unwarranted extension of federal jurisdiction to such a degree that it has become a contributing factor to further burden an already overburdened judicial system. However, the legal announcements in this extension of jurisdiction have resulted in conflicting and confusing legal concepts which have created contentions amongst the Circuit Courts of Appeals, as well as dissensions within the circuits.

There have been no definite or concise guidelines pronounced by this Court through the exercise of its supervisory jurisdiction to limit this unwarranted extension of jurisdiction by the trial and intermediary federal courts. The encroachment by the federal judiciary into the area of corporate activities has given much concern as to whether or not the federal judiciary, in its efforts to extend its jurisdiction, has enacted through opinion a body of federal corporation law.[19]

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[19]*See* Ruder, Pitfalls in the Development of Corporate Securities Law Through Implication of Rule 10b-5, **59 Northwestern L.Rev.** 185 (1964); Wettach, Securities Regulation—Rule 10b-5—A Federal Corporation Law?, **43 N.C.L.Rev. 637** (1965). It must be conceded that during the past eight

The extension of this jurisdiction is in fact an usurpation of the jurisdiction of the courts of the respective states, since they afford adequate and complete relief in most if not all of the matters involved in connection with the great body of corporation law. However, the continued usurpation of jurisdiction by the federal trial courts, condoned by the various Circuit Courts of Appeals, has extended to areas which were never in the contemplation of the Congressional purport and intent expressed in the Acts of 1933 and 1934, and the rules promulgated in accordance therewith by the SEC.

The case at bar is a typical example of condonation by the Fifth Circuit Court of Appeals of the unauthorized extension of federal jurisdiction by a district trial court. An extension which is in direct contravention of the legislative intendment of the statutes and rules involved. The approval contained in the opinion of the Fifth Circuit in question further exemplifies the appellate condonation of the unwarranted extension of federal jurisdiction by the utilization of generalities in the disposition of important issues without recognizing the inherent evil in the procedure, or without recognizing the true and concrete issues raised by the record below.

Therefore, this instant application for the writ of certiorari, in addition to calling to this Honorable Court's

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years the degree of erosion by the federal judiciary in the area of corporation law has been accelerated rather than limited.

Fleischer, Federal Corporation Law: An Assessment, **78 Harv.L.Rev. 1146** (1965); Ruder, Corporate Disclosures by the Federal Securities Laws: The Codification Implications of Texas Gulf Sulphur, **61 Northwestern L. Rev. 1967,** No. 6, article based upon a talk delivered at the Fifth Annual Corporation Counsel Institute held at Northwestern University School of Law October 13 and 14, 1966.

attention the conflicts created by the opinion in question, prays that there be an exercise of the supervisory jurisdiction of this Court to establish guideposts to readvise the federal judiciary that the trial courts are courts of limited jurisdiction which is to be invoked within the confines of the Constitution, the Treaties, and the Laws of the United States.

I.

Federal corporation law does not exist as a body of law which creates jurisdiction in the federal courts, and it cannot be utilized by a federal court to retain jurisdiction over a nonfederal claim in an attempt to correct a wrong. Thus, the opinion of the Fifth Circuit is an effort to condone this unwarranted jurisdiction by the trial court, and runs afoul of the pronouncements of this Court, and creates additional conflict between its sister circuits.[20]

The opinion under consideration is in direct contravention of the clearly enunciated doctrine of this Court, *see* **Hurn v. Oursler,** 289 U.S. 238, 53 S.Ct. 586, 589, 77 L.Ed. 1148 (1933); **Armstrong Paint & Varnish Co. v. Nu-Enamel Corp.,** 305 U.S. 315, 59 S.Ct. 191, 83 L.Ed. 195, *rehearing denied* 305 U.S. 675, 59 S.Ct. 356, 83 L.Ed. 437.

The decision is in conflict with the Fourth Circuit Court of Appeals, *see* **Rumbaugh v. Winifrede Railroad**

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[20]Where an individual cause of action seeks injunctive, accounting and receivership relief, it creates a conflict of interest so deep that such plaintiff cannot be afforded derivative relief, for the sought after individual primary relief precludes the maintaining of the suit to recover secondary rights. [**Zahn v. Transamerica Corporation** (CA3 1947) 162 F.2d 106; note 21, *infra*.]

Co. (CA 4 1964) 331 F.2d 530, *cert. denied* 379 U.S. 923, 85 S.Ct. 322, 13 L.Ed.2d 341 (1964).[21]

However, the insistence of the trial court to apply federal corporation law with the approval of the opinion under consideration leads to a conflict between the Fifth Circuit with its sister courts in the Second, Third, Ninth and Tenth Circuits. *See* **Popkin v. Bishop** (CA2 1972) 464 F.2d 714; **Knauff v. Utah Construction & Mining Co.** (CA10 1969) 408 F.2d 958; **DePova v. Camden Forge Co.** (CA3 1958) 254 F.2d 248.[22]

The opinion under consideration overlooks this Court's strong directive in **Superintendent of Insurance v. Bankers Life & Casualty,** 404 U.S. 6, 12, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971).[23]

We are once again reminded that the Fifth Circuit failed to recognize that before a federal court could retain a matter, the federal claim must have substance sufficient to confer subject matter jurisdiction on the court, and once it appears that only a state law cause of action exists and it constitutes the real body of the case to which

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[21]See **3B Moore's Federal Practice,** ¶ 23.1.16, pp. 23.1-101 thru 106, and Annotation at **5 ALR3d 1060-1062,** and cases cited therein.

[22]See also **Lanning v. Sherwood** (CA9 1973) 474 F.2d 716, 719; **5 Fletcher Cyc.Corp. § 2143.1** (Perm.Ed. 1967);

See a'so Shareholder Validation of Directors' Frauds: the Nonratification Rule vs. The Business Judgment Rule, **58 Northwestern L.Rev. No. 6** (1964); Landstrom, Ratification by Majority of Stockholders: A Problem in Corporate Democracy, **31 BUL L.Rev. 165** (1951); see also Note, **53 Harv. L.Rev. 1368** (1940).

[23]We agree that Congress § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." **404 U.S. at 12.**

a federal claim is only an appendage, the cause of action must be dismissed by the federal court and relegated to the state tribunals. **United Mine Workers v. Gibbs**, 383 U.S. 715, 725, 727, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966).

II.

The federal judiciary must invoke its jurisdiction to carry out the Congressional intent[24] within an atmosphere to sanctify its integrity and protect its honor to a degree which requires it to deny relief, *sua sponte* if necessary, to any wrongdoer.

This Court enunciated a doctrine which required the denial to a wrongdoer [Plaintiff—unclean hands], sua sponte if necessary, of any relief. [**Keystone Driller Co. v. General Excavator Co.**, 290 U.S. 240, 54 S.Ct. 146, 78 L.Ed. 293 (1933); **Morton Salt Co. v. Suppiger Co.**, 314 U.S. 488, 62 S.Ct. 402, 86 L.Ed. 363 (1942). **Precision Instrument Mfg. Co. v. Automative Maintenance Mach. Co.**, 324 U.S. 806, 65 S.Ct. 993, 89 L.Ed. 1381, (1945)].

The proceedings at bar were bottomed in equity [A. 58]. The lower federal courts dispensing equitable relief are required on their own to investigate the acts and conducts of a party plaintiff who seeks to set this judicial machinery in motion. These courts are required to ascertain that there was no violation of good conscience,

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[24]The Acts of 1933 and 1934 were never intended by Congress to permit a wrongdoer—in violation of the statutes, the rules of the SEC and the regulations promulgated by the Federal Reserve Board [**Regulation U** *(12 CFR §221.4)*], where such wrongdoer at the commencement of the original suit had recovered his original investment and realized a profit of $22,550, in addition to the retention of 14,000 shares of the security he wrongfully dealt in—to invoke the jurisdiction of the federal courts to guarantee a retention of such profits without accounting therefor.

good faith, or any other equitable conduct, by the plaintiff by his pre-suit acts; for if he acted with unclean hands and in fact violated the tenets of the statute under which he sought relief, the doors of the federal courts will be shut against him in limine.

Therefore, the opinion under consideration has refused to recognize this basic sua sponte investigation by a federal trial court to determine whether or not there should be a denial of relief because the acting Plaintiff did in fact violate the intent of the Congress as expressed in the statutes involved. The acts in question need not be unlawful, they need only be unconscionable or contrary to good morals. Thus, where the legislation condemns conduct of a party seeking relief in accordance with the statutory dictates, the courts are required to deny such wrongdoer any judicial determination. [**J. I. Case v. Borak**, 377 U.S. 26, 433, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964).]

In fairness to the situation, we remind the Court that in a recent anti-trust case[25] it announced a doctrine which precludes the raising of a defense of pari delicto in litigation involving violations of the anti-trust laws of the United States. This enunciation lead, either correctly or erroneously, to a recent decision in the Second Circuit Court of Appeals which expanded the nonavailability of a pari delicto defense to litigation involving violations of the Acts of 1933 and 1934 and the rules promulgated thereunder by the SEC. [**Pearlstein v. Scudder and German** (CA2 1970) 420 F.2d 1136, 1141.]

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[25]**Perma Life Mufflers v. Intern. Parts Corp.**, 392 U.S. 134, 88 S.Ct. 1981, 20 L.Ed.2d 982 (1968).

Yet, overlooked in the rush to accept the nonavailability of pari delicto and unclean hands defenses in securities litigation, is the enunciation of this Court that *pari delicto* and unclean hands should be recognized *sua sponte* in copyright, patent and trademark litigation. [*Keystone Driller Co. v. General Excavator Co., supra; Morton Salt Co. v. G. S. Suppiger Co., supra.*]

The availability of the defenses of *pari delicto* and unclean hands to one body of the law, and their unavailability in another body of the law, has created a divergence of decisions amongst the sister Circuit Courts of Appeals which has compounded the confusion. Finally, in at least one circuit, the denial of a defense of *pari delicto* in securities law has not been universal, thus creating a conflict within that particular circuit, *compare*, Serzysko, *infra*, with Pearlstein, *supra*.

We beg the Court's indulgence to examine the opinion under question, which deems unclean hands and *pari delicto* —even though the integrity and honesty of the court is involved—to be a discretionary matter, with the following decisions enunciated in the sister circuits, which stand in direct conflict with the opinion under consideration. In the Second Circuit, *see* **Serzysko v. Chase Manhattan Bank** (CA2 1969) 409 F.2d 1360, *affirming* **Serzysko v. Chase Manhattan Bank** (SDNY 1968) 290 F.Supp. 74; **Crane Co. v. Westinghouse Air Brake Co.** (CA2 1969) 419 F.2d 787, 793; **SEC v. Texas Gulf Sulphur** (CA2 1968) 401 F.2d 833, 858, 860, *cert. denied sub nom*, **Coates v. SEC**, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969). In the Third Circuit, *see* **Monsanto Co. v. Rohm & Haas Co.** (CA3 1972) 456 F.2d 592; **Gaudiosi v. Mellon** (CA3 1959) 269 F.2d 873,

882.[26] In the Seventh Circuit, *see* **Feist v. Young** (CA7 1943) 138 F.2d 972; in the Eighth Circuit, *see* **Earle R. Hanson & Assoc. v. Farmers Coop. Creamery Co.** (CA8 1968) 403 F.2d 65, 70. In the Ninth Circuit *see* **West Los Angeles Institute for Cancer Research v. Mayer** (CA9 1966) 366 F.2d 220, 227; **Republic Molding v. B. W. Photo Utilities** (CA9 1963) 319 F.2d 347, 350, and with **Kuehnert v. Texstar Corp.** (CA5 1969) 412 F.2d 700.

The modern text writers urge that permitting redress to a wrongdoer in securities litigation, in contravention of the Congressional intent and purpose of the Act, is indeed a sacrilege. They almost universally urge that it was the intent of Congress to force a profiteer to disgorge his profits prior to allowing relief.[27]

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[26]Judge Kalodner appeared firmly convinced that the unclean hands doctrine adversely affecting a plaintiff should require dismissal of a derivative stockholders suit, observing that justice may be blind, but it is not dumb.

[27]Bloomenthal, From Birnbaum to Schoenbaum: The Exchange Act and Self Aggrandizement, 15 N.Y.Law Forum 332 (1969); DeLancey, Rule 10b-5—A Recent Profile, 25 Business Lawyer 1355 (July 1970); The Impact of Class Actions on Rule 10b-5, 38 U.Chi.L.Rev. 337 (1971); Rapp and Loeb, Tippee Liability and Rule 10b-5, U.Ill.L.Forum, Vol. 1971, No. 1, pp. 55-90. [Messrs. Rapp and Loeb conclude that ". . . when tippees have the same knowledge as insiders, there is little difference between their relative culpability and potential for harm. Arguably the same arsenal of remedies that can be invoked against insiders should be available to deter and punish tippees and to compensate their victims. They should be enjoined, disciplined by the SEC, subjected to criminal sanctions, and made to pay actual and, if appropriate, punitive damages to injured persons. . . ." ". . . If the courts are willing to impose so severe a sanction on insiders, then the same sanctions should be imposed on tippees, when their knowledge makes them equally culpable." (at p. 88)] The Respondents here were both insiders and tippees. *See also* Fosshay, Market Activities of Participants in Securities Distributions, 45 Va.L.Rev. 907 (1959); Bloomenthal. Market-Makers, Manipulators and Shell Games, 45 St. John's L.Rev. 597 (1971); Jennings, Insider Trading in Corporate Securities: A Survey of Hazards and Disclosure Obligations Under Rule 10b-5, 62 Northwestern L.Rev., No. 6 (1968), from a

III.

This Court has never made a clear expression as to the operative effect of Federal Rule of Civil Procedure 23.1. The question as to whether or not its provisions are mandatory and must be complied with both in pleading and proof by any party seeking derivative relief from the federal judiciary remains unanswered. The rule is direct, clear and concise. Yet it has been made the operative force to extend and expand the jurisdiction of the federal courts, in contravention of the clear edict enunciated in Federal Rule of Civil Procedure 82.

When Rule 23.1 was promulgated, it did not—as its predecessor, former Rule 23(b)—seek to divest state courts of their jurisdiction to try charges of corporate mismanagement and grant minority dissident stockholders relief. The rule itself was not intended to broaden and widen the jurisdiction of the federal courts.

The opinion below is in direct conflict with a recent decision of the Sixth Circuit Court of Appeals; *see* **Nolen v. Shaw-Walker Co.** (CA6 1971) 449 F.2d 506, 508. The **Nolen** decision cannot be reconciled with the opinion below.

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paper delivered at the Sixth Annual Corporation Counsel Institute held at Northwestern University School of Law October 13 and 14, 1967.

See also opinion of Circuit Judge Friendly in **Katz v. Amos Treat Co.** (CA2 1969 411 F.2d 1046, 1054; see also **Mott v. Tri-Continental Financial Corp.** (CA2 1964) 330 F.2d 468, 471; **Straley v. Universal Uranium and Milling Corp.** (CA9 1961) 289 F.2d 370, 373; and one should not overlook this Court's admonition in **Deckert v. Independence Shares Corp.**, 311 U.S. 282, 287-288 (1940).

We ask ourselves what disposition the Sixth Circuit would have made of the case at bar since the Respondents failed to verify their complaint, and failed to allege that they fairly and adequately represented the interests of shareholders or members similarly situated in enforcing the rights of the corporation. This latter omission, compounded by a complete lack of proof of unanimity of fairly and adequately representing the interests of others similarly situated, in the light of the percentile of stock held by the Respondents, would no doubt have resulted in the Sixth Circuit denying any and all relief to the said Respondents, without reaching the question of clean hands and pari delicto, sua sponte or otherwise.

IV.

The opinion below fails to recognize that a federal trial court is governed by the substantive provisions of the state statutes, and in violating this mandate the opinion below runs afoul of the law of the State of Florida as well as the enunciations of this Court.

Again we find deep dissidence since the opinion under consideration refuses to accept the statutory dictates and this Court's rulings. Florida statute of limitations[28] involved in causes of action instituted to recover considerations paid or received in connection with securities frauds, requires as a condition precedent to maintaining the action within a two-year period the tendering of the securities in exchange for the consideration. The statute contains limitations of recovery similar to those limitations of recovery set forth in the Acts of 1933 and 1934.[29]

[28] **F.S.A. § 517.21(1)**, pg. 18, *supra*.

[29] See **15 U.S.C. §§ 771, 78bb, and F.S.A. § 517.21**, pp. 8, 9 and 18, *supra*.

In contravention of this Court's ruling in Reading Co. v. Koons, 271 U.S. 58, 46 S.Ct. 405, 406, 70 L.Ed. 835 (1936) the opinion under consideration regards a state statute of limitations controlling only as to those "chronometric aspects." Thus, we find a disregard for the rules of decision legislation which limits the federal judiciary's jurisdiction.[30]

V.

The Congressional intendment as expressed in the Acts of 1933 and 1934 were basically remunerative in their remedial aspects [**Herpich v. Wallace** (CA5 1970) 430 F.2d 792, 804]. Thus, the opinion under consideration once again runs afoul of the Congressional intention, since it bestows upon a federal trial court jurisdiction to grant relief beyond the Congressional limitation. The Respondents below were more than whole at the time of the commencement of the proceedings in connection with their investment. In fact, if they were required to account, they could not be classified as stockholders, since the 14,000 shares of IGB that they held at the time of the commencement of the proceedings represented no financial investment on their part. In addition thereto, they had realized some $21,550 profit.

It was never the Congressional intention by the enactment of the legislation under consideration to grant a right of action to parties allegedly aggrieved hereunder to be guaranteed a profit and be permitted to maintain a lawsuit in furtherance of obtaining additional profits. [See Hearings on Stock Exchange Regulations before the

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[30]Note 7 *supra*, pg. 10, *supra*.

House Committee on Interstate and Foreign Commerce, 73rd Congress, 2d Sess. 1934, p. 115; 3 **Loss, Security Regulation** 1424 (2nd Ed. 1961); Sec. Exch. Act Rel. No. 3230 (5-21-42), 8 **SEC Ann. Rep.** 10 (1943.]

Yet the opinion below would permit a substantial wrongdoer, in violation of the legislation he seeks to invoke for his remedy, not only to retain his profit, but to prosecute a cause of action to further benefit from his wrongdoing.

To recognize such proceedings under the Acts of 1933 and 1934 would be such a severe departure from the Congressional intention that it in fact would mark the return to an era of stockholder "strike" suits maintained through manipulative chicanery.

VI.

The opinion below is in conflict with this Court's direction governing a reviewing court's application of the clearly erroneous doctrine. The decision below seeks to invoke a concept of the truth and right of the case in the review of the entire record, rather than the required concept that a reviewing court in examining the record and the inferences drawn therefrom, if convinced that a mistake has been committed, is then required to set aside the judgment of the trial court. Thus, the decision below is in conflict with this Court's mandate; see **United States v. United States Gypsum Co.**, 333 U.S. 364, 395, 68 S.Ct. 525, 92 L.E.d. 746 (1948).

The opinion's refusal to follow the foregoing mandate of this Court creates a conflict with the status of the law in the Sixth Circuit in Texas Continental Life Ins. v. Dunne (CA6 1962) 307 F.2d 249.

The basic mistake made by the trial court was that it failed to recognize *sua sponte* the inequitable position of the Respondents, their failure to plead and prove that they fairly and adequately represented members of a class similarly situated; and finally, that more than ninety-nine per cent of the stockholders, as well as all of the directors of IGB, approved the September 19, 1969 transaction which was made the basis of the derivative recovery.[31]

It is therefore clear that the misapplication of the clearly erroneous doctrine by the reviewing court prevented the court from examining the record to make a determination in connection with the basic mistake or mistakes committed by the trial court, and again shows a conflict with the opinions of this Court, as well as those of the Sixth Circuit.

[31]No additional amplification need be had in connection with lack of jurisdiction, nondiversity, insufficiency of amount in controversy, and the conflict between the primary recovery in direct opposition to the secondary derivative recovery.

CONCLUSION

For the reasons aforesaid, which present substantial issues, raising questions of jurisdiction and the application of this Court's supervisory jurisdiction, it is respectfully prayed that a writ of certiorari be granted to review the judgment of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term 1972

ROBERT R. FRANK, et al.,
Petitioners,

vs.

J. WILLIAM WOLF, et al.,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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APPENDIX

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MIAMI REVIEW — 371-4853 — 377-3721

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NO. _____

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 72-2534

J. WILLIAM WOLF, ET AL,
Plaintiffs-Appellants-
Cross Appellees,

versus

ROBERT R. FRANK, ET AL,
Defendants-Appellees-
Cross Appellants.

Appeals from the United States District Court for the Southern District of Florida

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(April 24, 1973)

(Reported at 477 F.2d 467)

Before RIVES, GOLDBERG and MORGAN,
Circuit Judges.

GOLDBERG, Circuit Judge: This is an appeal and cross-appeal from a judgment of the United States District Court for the Southern District of Florida awarding plaintiffs, J. William Wolf and Pearl M. Wolf,

shareholders of Industrial-Guaranty Bancorp (hereinafter "IGB"], individual and derivative relief from defendants, IGB, Robert R. Frank, Jack H. Stein, and John W. Roberts, Jr., for violations of the Securities Act of 1933, 15 U.S.C. § 77a et seq., and the Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq. Although not an overly complicated securities case, its presentation sometimes gives the appearance that the geometry of the case would defy the law that a straight line is the shortest distance between two points. Both plaintiffs and defendants appeal from numerous substantive and procedural aspects of the District Court's judgment, which deviate from the essentials of the decision. The only claim we find meritorious, however, is plaintiffs' argument that Mills v. Electric Auto-Lite Co., 1970, 396 U.S. 375, 90 S.Ct. 616 24 L.Ed.2d 593, entitles them to be reimbursed by IGB for the cost of maintaining this derivative claim. The District Court's order is therefore affirmed in all things but the denial of plaintiffs' plea for reimbursement for the costs of maintaining this action.

I. THE OPERATIVE FACTS

The District Court made numerous and detailed findings of fact and conclusions of law that have greatly aided this Court in its resolution of this complex appeal. Not all of these findings and conclusions are involved in this appeal; thus, we here summarize only those matters necessary for an understanding of our disposition of the case.

In early 1969, plaintiff J. William Wolf began discussing with defendants Robert R. Frank and Jack H. Stein the possibility of his investing in IGB, a Florida corporation with its principal place of business in Florida.

Defendants Frank, Stein, and Roberts[1] organized IGB with the intention of making it a bank holding company, and they served at all relevant times as officers and directors of IGB. Plaintiff repeatedly met with defendants, in various combinations, to discuss IGB. Prior to plaintiffs' initial purchase, defendants Stein and Frank represented to plaintiff that they were going to allow not more than fifteen of their friends to purchase shares in IGB before making a proposed public offering: They represented that everyone would pay $2.00 cash per share and that there would be no free stock or fringe benefits.[2] In reliance upon these and other representations concerning (1) an application by IGB to the Federal Reserve Board for approval as a bank holding company, (2) the acquisition plans of IGB, and (3) the progress of registration of IGB shares with the Florida Securities Commission, plaintiffs purchased 37,500 shares of IGB stock for $75,000.00 between July 28, 1969 and October 8, 1969. No registration statement was then in effect as to those securities.

As early as July 24, 1969, prior to the initial purchase of IGB stock, plaintiff began inquiring among his friends about resales to them of the IGB stock that was to be purchased. During the six-month period beginning in late July, 1969, plaintiffs sold at least 23,000 of their 37,500 shares to approximately fourteen persons in various parts of the United States at prices ranging from $2.00 to $5.00 per

[1]In this opinion Robert R. Frank, Jack H. Stein, and John W. Roberts, Jr. will be referred to as "defendants" and J. William Wolf will be referred to as "plaintiff."

[2]Although defendant Roberts was present when some of these representations were made, the District Court found that there was no credible evidence that he made any affirmative representations.

share. In these transactions plaintiffs realized a total of $95,000.00, some $20,000 more than they had paid for all their IGB stock.

In fact, an application for approval as a bank holding company was never filed on behalf of IGB. Furthermore, defendants did not pay $2.00 cash per share when they acquired their own stock interest in IGB. First, in September, 1969, defendants exchanged 19,826 shares of stock in the National Industrial Bank [hereinafter NIB] with IGB for 346,995 newly issued shares of IGB stock, pursuant to an exchange ratio computed by defendant Roberts. At the exchange value of $2.00 per share, the IGB stock acquired in the exchange by defendants was worth $693,910.00. The NIB stock that the corporation received from defendants in exchange was worth considerably less. It had been purchased by defendants in January, 1968 for $198,260.00, or $10.00 per share, and was selling for $10.00 per share in October, 1969. Second, on January 16, 1970, defendants received 184,935 shares of IGB stock in exchange for non-interest bearing, unsecured promissory notes in the amount of $369,870.00 due in 1973.

A voting trust agreement reflects that defendants controlled 1,336,391 voting shares of IGB and were at all material times in control of the company. Although IGB's Certificate of Incorporation requires the directors to fix the value of any property received by the corporation in exchange for stock, this was not done in conjunction with the transfer by defendants of their 19,826 shares of their NIB stock for 346,995 shares of IGB stock [hereinafter the "NIB-IGB stock exchange"]. In that exchange, a ratio of 17½ to 1 was the basis used, and the value of the IGB stock was calculated at its par of $1.00 per share. Under

this ratio, defendants received the equivalent of $17.50 per share for their NIB stock. If the transaction had been based on payment of $2.00 per share for the IGB stock, the sum that defendants had represented would be paid and that everyone else did in fact pay, then defendants actually received what amounted to $35.00 per share for their NIB stock, which was worth no more than $10.00 per share. The required valuation was also neglected in connection with the issuance of stock to defendants in exchange for their promissory notes.

At a directors meeting held on January 16, 1970, defendants, acting as directors, elected three additional directors, with defendants abstaining, authorized defendants to purchase the aforementioned 184,935 shares of IGB stock by executing noninterest bearing, unsecured notes in the total amount of $369,870. At the same time that these non-interest bearing and unsecured notes of defendants were outstanding, IGB borrowed greater sums from banks at interest rates varying from 7½ percent to 9½ percent per annum. Such loans were fully secured by part of the assets of IGB. The newly constituted board of directors, with defendants voting, "ratified" the NIB-IGB stock exchange and all other actions taken on previous occasions by defendants as directors. No annual or special meeting of stockholders of which plaintiffs received notice was held until January 21, 1971.

II. ACTION BELOW

Soon after the meeting of January 21, 1971, plaintiffs brought this action both individually and derivatively as stockholders of IGB against defendants. The complaint charged that: (1) misrepresentations, omissions, and acts

of defendants constituted a manipulative and deceptive device and contrivance and a scheme and artifice to defraud in connection with the sale of securities of IGB to plaintiffs, all of which was in violation of Rule 10b-5;[3] (2) sale by defendants to plainttiffs of the IGB stock constituted a violation of Section 5 of the Securities Act of 1933, 15 U.S.C. §77e, because no registration covering the securities had been declared effective by the United States Securities and Exchange Commission; (3) defendants committed common-law fraud in connection with plaintiffs' purchase of IGB stock.[4]

Relying on Rekant v. Desser, 5 Cir. 1970, 425 F.2d 872, the District Court found that plaintiffs had established a derivative Rule 10b-5 violation by defendants in that defendants' activities in the NIB-IGB stock exchange constituted a fraudulent issuance of stock to insiders for grossly inadequate consideration. The District Court found that the NIB stock was worth $198,260.00 and that therefore defendants paid approximately $.57 per share of IGB stock issued to them, or $1.43 less than the $2.00 per share that defendants represented that they would pay for their IGB purchase. The Court ordered defendants to reimburse IGB $1.43 per share of IGB received in the fraudulent transaction. The District Court also found, however, that plaintiffs were not entitled to individual relief under Rule 10b-5 because they failed to show any actual individual damages in connection with the sale or purchase of IGB

[3]Rule 10b-5 was adopted by the United States Securities and Exchange Commission pursuant to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j.

[4]It was stipulated that the activities complained of were accomplished by the use of means and instrumentalities of interstate commerce and the mails.

stock, since through their own sales of IGB stock they had made a profit of approximately $20,000.00 in addition to the value of the IGB shares they retained.

The District Court relied on Hill York Corp. v. American International Franchises, Inc., 5 Cir. 1971, 448 F.2d 680, in finding that defendants had violated Section 5 of the Securities Act of 1933 and in granting the individual plaintiffs the option of rescinding their purchase of 14,000 shares of IGB stock. The Court also held that Section 5 of the 1933 Act did not authorize derivative relief for the corporate entity.

Finally, the District Court found that defendants breached their fiduciary duty on January 16, 1970 by paying for IGB stock with non-interest bearing notes. The Court ordered defendants to pay IGB 7½ percent back-interest on the $369,870.00 note, from January 16, 1970 to the date of the judgment.

The District Court, however, refused to find that plaintiffs were entitled to be reimbursed for the costs of maintaining a derivative action for IGB. The Court also refused to appoint a receiver or to grant other equitable relief sought by plaintiffs.

On cross-appeal, defendants contend that the District Court erred by: (A) failing to recognize plaintiffs' unclean hands and to take appropriate remedial actions against plaintiffs; (B) failing to rule that the derivative Rule 10b-5 claim was barred by the statute of limitations; (C) allowing plaintiffs to maintain a derivative action; (D) failing to give proper weight to defendants' evidence concerning the value of the NIB stock exchanged for IGB

stock; and (E) substituting its business judgment for that of the IGB stockholders and directors who ratified defendants' activities.

Plaintiffs contend on direct appeal that the District Court erred by: (A) refusing to grant plaintiffs individual relief pursuant to Rule 10b-5; (B) not granting interest to IGB on the judgment recovered from defendants; (C) dismissing plaintiffs' derivative Section 5 claim; (D) failing to grant further equitable relief to correct defendants' wrongdoing; and (E) denying plaintiffs' request for reimbursement for the costs of attorneys' fees and expert witness fees incurred in maintaining the derivative claim.

III. DEFENDANTS' APPEAL

The defendants' briefs and arguments are predicated upon facts and inferences and conclusions that the trial court neither found nor was compelled to find. In the welter of charges and counter charges the ensuing obfuscation can be visioned away by the application of a relatively few simple legal propositions, the most elementary principle being that appellate courts are governed by the "clearly erroneous" test of Rule 52(a) of the Federal Rules of Civil Procedure when they review District Court fact findings. In applying this test, we have said:

> "The question is not simply whether the reviewing court would have found otherwise but whether the trial court could permissibly find as it did. The reviewing court should upset a finding only when it 'is convinced on the whole record that the finding does not reflect the truth

and right of the case.' Wright, Federal Courts § 96, at 432."

Movible Offshore, Inc. v. M/V Wilken A. Falgout, 5 Cir. 1973, 471 F.2d 268, 271. Defendants' brief oftentimes totally fails to evidence an awareness, much less an understanding, of this controlling principle of appellate jurisprudence.

A. Equitable Defenses

Defendants contend that the facts clearly establish that plaintiffs were manipulating market-makers who violated applicable statutes and Securities and Exchange Commission rules by selling IGB stock before actually acquiring it. Claiming that this factual contention gives rise to a defense of "unclean hands," defendants urge that the District Court erred by: (1) finding that defendants violated Section 5 of the Securities Act of 1933[5] and there-

[5]Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e provides:

"(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

"(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or

upon granting plaintiffs an option to rescind[6] pursuant to the remedial provisions of Section 12 of the Securities Act of 1933;[7] (2) not creating a constructive trust on behalf of the parties who purchased IGB stock from plaintiffs; and (3) not requiring plaintiffs to rescind their purchase of IGB stock.

Without passing on the merits of defendants' factual contentions, we deem it sufficient to say that defendants' arguments are misguided. While the defense of "unclean hands" is available in securities actions in this Circuit, Kuehnert v. Texstar Corp., 5 Cir. 1969, 412 F.2d 700, its application rests within the sound discretion of the District Court. Whether the defense is allowed should be determined by ascertaining whether the application or non-application of the defense will better promote the

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preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

"(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title."

[6]Plaintiffs elected not to rescind their purchase of the remaining shares of IGB stock.

[7]Section 12 of the Securities Act of 1933, 15 U.S.C. § 77e, provides in relevant part:

"Any person who — (1) offers or sells a security in violation of section 77e of this title [§ 5] . . . shall be liable to the person purchasing such security from him, who may sue either at law or in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

objectives of the securities laws by increasing the protection afforded the investing public. Id. The District Court did not abuse its discretion in refusing to bar plaintiffs from maintaining a suit to enforce the requirements of Section 5 of the Securities Act of 1933.

After carefully considering the record, we have determined that no party in the Court below ever took the position, by pleadings or otherwise, that a constructive trust should be imposed in favor of those who purchased from plaintiffs. Without deciding the question of defendants' standing to seek such relief in the District Court, we conclude that because defendants did not in fact seek such relief below they cannot now raise a new theory that was not presented to the District Court. Hill York Corp. v. American Internat'l Franchises, Inc., 5 Cir. 1971, 448 F.2d 680, 690; Overmyer Co. v. Loflin, 5 Cir. 1971, 440 F.2d 1213, cert. denied, 1971, 404 U.S. 851, 92 S.Ct. 87, 30 L.Ed.2d 90.

Finally, we find that the District Court properly declined to find that plaintiffs were required to accept the remedy of rescission afforded with regard to their remaining shares. Plaintiffs invoked the jurisdiction of the federal court both under Section 5 of the Securities Act of 1933 and under Rule 10b-5, and were not required to elect the remedy of rescission proffered in settlement by defendants prior to trial, since that election would have been inconsistent with plaintiffs' capacity to maintain their derivative Rule 10b-5 complaint. United States v. Borin, 5 Cir. 1954, 209 F.2d 145, cert. denied, 1954, 348 U.S. 821, 75 S.Ct. 33, 99 L.Ed. 647; Breeding v. Massey, 8 Cir. 1967, 378 F.2d 171.

B. Statute of Limitations

Defendants argue that the District Court erred in not ruling that plaintiffs' individual and derivative Rule 10b-5 claims were barred by the statute of limitations. In actions for relief brought pursuant to Rule 10b-5 the applicable statute of limitations is that of the state in which the federal court sits. Hooper v. Mountain State Securities Corp., 5 Cir. 1960, 282 F.2d 195, cert. denied, 1961, 365 U.S. 814, 81 S.Ct. 695, 5 L.Ed.2d 693. Defendants nevertheless contend that even though plaintiffs filed this action within the two-year Florida statute of limitations, which defendants argue is applicable under F.S.A. § 517.21, plaintiffs are barred because they failed to tender their securities to defendants as required by F.S.A. § 517.21. Plaintiffs reply that Florida's three-year statute of limitations for actions brought for relief on the ground of fraud, F.S.A. § 95.11, is applicable and that they fall well within that time period.

Defendants' argument misconceives the issue. This suit was maintained in the District Court under Rule 10b-5, not under pendent jurisdiction of a state claim. When applying the forum's statute of limitations to actions brought under the federal securities laws, federal courts borrow only the chronometric aspects and not the procedural or substantive nuances of the law of the forum. We therefore find it unnecessary to determine whether the applicable statute of limitations is the two-year limitation embodied in Section 517.21 or the three-year limitation of Section 95.11 because plaintiffs commenced this action well within either period of limitation.

C. Plaintiffs' Standing to Maintain the Derivative Claim

Defendants next maintain that the District Court erred in allowing plaintiffs to maintain the derivative Rule 10b-5 claim on behalf of IGB because at no time material to the occurrences complained of were plaintiffs stockholders of IGB entitled to maintain a derivative stockholders' suit. See Fed. R. Civ. P. 23.1.[3] Defendants contention, supported more by invective and vituperation than by scholarly analysis or citation of authority, is apparently based on a belief that: (1) plaintiffs' allegedly unclean hands bar them from maintaing a derivative suit; or (2) the fact that plaintiffs made a profit in excess of their original investment divests them of stockholder status, even though plaintiffs at all relevant times re-

[3]Rule 23.1 provides:

"In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs."

tained approximately 14,000 shares of IGB stock; or (3) the District Court was "clearly erroneous" in finding that plaintiffs at all times retained 14,000 shares of IGB.

We hold that the District Court did not err in allowing plaintiffs to maintain the derivative Rule 10b-5 claim. Defendants are purblind to the fact that this is not a case of a brigand seeking to recover his loot. Plaintiffs' actions, alleged to be illegal, were in no way involved with the transactions for which the District Court granted derivative relief. Furthermore, although defendants contend that plaintiffs are economic pirates disqualified because of their piracy from representing an innocent corporation, the District Court made no such finding and in fact found that only defendants were picaroons. Whether plaintiffs were or were not knights in shining armor is irrelevant under Rule 23.1 of the Federal Rules of Civil Procedure, so long as they fairly and adequately represented the shareholders in enforcing the rights of IGB. Assuming, without deciding, that unclean hands might bar plaintiffs from maintaining a derivative Rule 10b-5 claim, we find that the District Court exercised its discretion properly when it refused to find plaintiffs barred under the doctrine.[9]

We next find that the fact that plaintiffs made a profit on their original investment in no way alters their status as stockholders or their standing to bring a derivative claim. That plaintiffs' stock represented a profit to them does not alter its status as stock for the purposes of Rule 23.1 of the Federal Rules of Civil Procedure. As long as plaintiffs actually owned stock at the time of the

[9]See Section A, supra.

challenged actions, then plaintiffs have standing to maintain a non-collusive Rule 10b-5 claim under the provisions of Rule 23.1.

Finally, we hold that the District Court's finding that plaintiffs resold all but 14,000 of their shares of IGB was not clearly erroneous. Neither by selectively reading the record, nor by isolating words and phrases, can defendants establish that plaintiffs were not shareholders at the critical and crucial times. The transcript and record, when fairly and comprehensively examined in their entirety, amply support the District Court's finding that plaintiffs were stockholders at the time of the occurrences they attack.

D. Valuation of the NIB Stock

Defendants assert that the District Court erred in valuating the 19,826 shares of NIB stock that they exchanged for 346,995 shares of IGB stock in the NIB-IGB stock exchanged. More specifically, defendants insist that the Court did not give proper weight to general trade practices concerning controlling stock and to other evidence in support of defendants' belief that the exchange rate was not detrimental or unfavorably harmful to IGB. We cannot agree. The District Court, the finder of fact, held: "Under any measure of value, the NIB stock was greatly overvalued in the exchange." We have considered the record before us, and under the limited factual review open to us, see Fed. R. Civ. P. 52(a); Movible Offshore, Inc. v. M/V Wilken A. Flagout, 5 Cir. 1973, 471 F.2d 268, 271, we are unable to say that the District Court's valuation of NIB stock was clearly erroneous.

E. Stockholder and Director "Ratification"

Defendants contend that the District Court wrongfully substituted its business judgment for that of the Board of Directors of IGB. Defendants urge that this is especially so in light of the fact that the IGB stockholders allegedly ratified the corporate directors' actions. The problem with this contention is that defendants have failed to adduce adequate evidence that in any way shows that the stockholders of IGB made a knowing ratification of either the NIB-IGB stock exchange or of the sale of IGB stock for unsecured, non-interest bearing notes.[10] We therefore refuse to hold that the stockholders of IGB ratified the activities found by the District Court to be fraudulent.

The only action that we have discovered in the record that arguably constitutes a ratification of defendants' action is that taken by the newly constituted Board of Directors on January 16, 1970. At that time, the defendants themselves elected three new members to the IGB Board, and the newly constituted Board. with all three defendants participating, then held two different votes to ratify defendants' past actions as directors. The newly elected directors, with defendants abstaining, also voted to sell defendants additional IGB stock for unsecured, non-interest bearing notes. We are mindful of the Florida rule that "[i]t cannot be disputed that a board of directors of a corporation is without power to ratify that which it cannot do directly or that which it could not authorize to

[10]We have carefully examined the documents cited by defendants as supporting this argument. We find no support in them for the notion that the IGB stockholders ratified either of the transactions in question.

be done initially. It has no power to ratify a void or illegal act." Flight Equipment & Engineering Corp. v. Shelton, 103 So.2d 615, 621 (citations omitted) (1958). We also recognize the general rule that "[r]atification can never be made on the part of the corporation by the same persons who worngfully assume the power to make the contract."

Fletcher Cyc. Corp. § 761, p. 1067. Guided by the rule of Flight Equipment & Engineering Corp. v. Shelton, supra, we hold that the votes of the newly elected directors could not legally authorize defendants to breach their fiduciary duties by accepting IGB stock for unsecured, non-interest bearing notes at the same time that IGB was borrowing money at interest rates varying from 7½ percent to 9½ percent per annum. Moreover, the votes of the newly constituted Board of Directors, in which defendants participated, could not constitute a valid ratification of defendants' illegal activities.

We find that the fact that the fraud was committed by a director of IGB in no way provides these defendants with an impenetrable "business judgment" shield. See Bankers L. & C. Co., 1971, 404 U.S. 6, 10, 92 S.Ct. 165, 30 L.Ed.2d 128, 133. There could "be no more effective way to emasculate the policies of the federal securities laws then to deny relief solely because a fraud was committed by a director rather than by an outsider." Ruckle v. Roto American Corp., 5 Cir. 1964, 339 F.2d 24, 28. As the District Court held, and as this Court stated in Rekant v. Desser, supra, 425 F.2d at 882:

> "[W]hen officers and directors have defrauded a corporation by causing it to issue securities for grossly inadequate consideration to themselves or

> others in league with them or the one controlling them, the corporation has a federal cause of action under § 10b and Rule 10b-5. . . ."

Defendants' arguments to the contrary are meritless.

IV. PLAINTIFFS' APPEAL

A. Plaintiffs Individual Rule 10b-5 Claim

The District Court dismissed plaintiffs' individual Rule 10b-5 claim because plaintiffs were unable to show any actual damages inasmuch as the dilution of their equity interest was not a cognizable element of damages for a violation of Rule 10b-5. Plaintiffs argue that Swanson v. American Consumer Industries, Inc., 7 Cir. 1969, 415 F.2d 1326, and Boggess v. Hogan, N.D. Ill. 1971, 328 F.Supp. 1048, establish that the dilution of a shareholder's equity interest is a cognizable element of damages for violation of Rule 10b-5 and that their equity interest was in fact diluted by (1) the NIB-IGB stock exchange, and (2) defendants' misrepresentations and omissions, which greatly altered the composite picture of the corporation from that represented to plaintiffs at the time of their initial purchase of IGB stock.

In Swanson v. American Consumer Industries, Inc., supra, the Seventh Circuit held that the dilution of equity interest is an appropriate measure of damages where dilution was caused by fraud in connection with a purchase or sale in which the claimants participated. Boggess v. Hogan, supra, held that individual stockholders could maintain Rule 10b-5 claims when fraud in connection with a purchase or sale in which their corporation participated diluted the equity position of the corporation, and thus

does support plaintiffs' argument. This Circuit, however, has already rejected the result reached there. In Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, we refused to allow shareholders of a corporation to maintain an individual Rule 10b-5 claim arising out of a fraudulent purchase by their corporation. We held that: "we are of the opinion that only purchasers and sellers of securities involved in an alleged Rule 10b-5 violation — that is, securities in connection with which fraud has allegedly been committed — can show injury of the type the rule is meant to prevent." Id., 430 F.2d at 806. In short, a reading of Swanson with Herpich establishes that plaintiffs do not have standing to seek individual damages for the dilution of equity interest caused by the NIB-IGB stock exchange because plaintiffs were neither purchasers nor sellers in connection with that transaction.

Plaintiffs also contend that their equity interest was diluted by defendants' failure to fulfill the promises that had induced plaintiffs to purchase IGB stock. The District Court held that because plaintiffs had already made a profit of approximately $20,000 on their IGB stock, they were unable to show any damages arising out of their purchase. Typically in Rule 10b-5 damage actions:

> "[d]efrauded buyers who have prevailed on the merits have . . . recovered their purchase price on a recission measure of damages, whether or not formally suing for recission. In an appropriate situation, e.g., if the securities are not worthless, a buyer can keep them and recover damages for the difference between the price paid and the real value when bought. This is an out of pocket rule not covering expected speculative profit."

2 A. BROMBERG, SECURITIES LAW: FRAUD, § 9.1, p. 226, at nn. 2-4 (emphasis added) (1971). We find that this is the appropriate measure of damages. Therefore, in light of the facts that: (1) the District Court awarded plaintiffs the option to rescind the purchase of their remaining shares of IGB; (2) plaintiffs have already made a $20,000 profit on their original purchase of IGB stock; and (3) Rule 10b-5 only provides for recovery of actual damages, 15 U.S.C. 78bb, and not for loss of speculative profits, Schaeffer v. First National Bank of Lincolnwood, N.D. Ill. 1970, 326 F.Supp. 1186, 1193, appeal dismissed, 7 Cir. 1972, 465 F.2d 234; Ross v. Licht, S.D. N.Y. 1967, 263 F.Supp. 395, 410,[11] plaintiffs are unable to show that they suffered any damages compensable under Rule 10b-5.

B. Prejudgment Interest

Plaintiffs' contend that the District Court erred in not granting interest on the moneys that the Court ordered defendants to reimburse to IGB in connection with the NIB-IGB stock exchange. Relying on Joseph E. Bennet Co. v. Trio Industries, Inc., 1 Cir. 1962, 306 F.2d 546, plaintiffs claim that the right to recover interest on a claim is a state question and that Florida law requires that IGB recover interest on the judgment entered in its favor.

[11]Although Southern Ice Co. v. Morris, 5 Cir. 1915, 219 F. 551, has been cited by the Seventh Circuit in Estate Counselling Service v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 7 Cir. 1962, 303 F.2d 527, 533, as holding that speculative profits are recoverable in Rule 10b-5 actions, we think that Southern Ice Co., which was decided prior to the passage of both the Securities Act of 1933 and the Securities Exchange Act of 1934, is not controlling authority for that position.

Plaintiffs reliance on Joseph E. Bennet Co. v. Trio Industries, Inc., supra, is erroneous. Bennet was a diversity case where state substantive law clearly would be controlling, and it is thus of no weight in an action brought pursuant to the federal securities laws. In determining whether prejudgment interest is allowed on damages awarded pursuant to Rule 10b-5, federal law governs. Ross v. Licht, supra, 263 F.Supp. at 411. Rule 10b-5, like Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), "being a federal right, its remedial aspects also are a matter of federal law." Gilson v. Chock Full O' Nuts Corp., 2 Cir. 1964, 331 F.2d 107, 109. Under federal law, whether prejudgment interest should be awarded on a damage recovery in a Rule 10b-5 action is a question of fairness resting within the District Court's sound discretion, Blau v. Lehman, 1962, 368 U.S. 403, 414, 82 S.Ct. 451, 7 L.Ed.2d 403, 411; Wessels v. Buhler, 9 Cir. 1971, 437 F.2d 279, 284; Notre & Co. v. Huffines, 2 Cir. 1969, 416 F.2d 1189, 1191-92, cert. denied sub nom. Muscat v. Notre & Co., 1970, 397 U.S. 989, 90 S.Ct. 1121, 25 L.Ed.2d 396. We perceive no abuse of discretion in the District Court's denying IGB prejudgment interest in the instant case.

C. The Derivative § 5 Claim

The District Court awarded defendants summary judgment on plaintiffs' derivative claim seeking damages for violations of Section 5 of the Securities Act of 1933, which was brought pursuant to the remedial provisions of Section 12 of the Act. The Court below reasoned that "Section 12 affords a remedy to the purchaser alone where there has been noncompliance with Section 5. It is not argued that the Section 5 violation here resulted in injury

to the issuer." Plaintiffs contend that this ruling was erroneous because defendants had not carried their burden of proof on a motion for summary judgment. This argument misses the point. Section 12, in terms,[12] provides a remedy for violations of Section 5 only to purchasers of securities, Schoenbaum v. Firstbrook, S.D. N.Y. 1967, 268 F.Supp. 385, 396, aff'd, 2 Cir. 1968, 405 F.2d 200, rev'd en banc on other grounds, 2 Cir. 1968, 405 F.2d 215, cert. denied, 1969, 395 U.S. 906, 89 S.Ct. 1747, 23 L.Ed.2d 219, or to one who stands in the shoes of a purchaser. American Bank & T. Co. v. Barad Shaff Securities Corp., S.D. N.Y. 1972, 335 F.Supp. 1276. Plaintiffs' derivative Section 5 claim does not involve any purchase of securities by IGB and therefore was properly dismissed.

D. Equitable Relief

Plaintiffs next argue that the District Court erred in failing to enjoin defendants from voting their shares of IGB until the shares were fully paid for. In determining whether further equitable relief was necessary, the District Court exercised its discretion to fashion a remedy that would most fully comport with the purposes of the applicable federal securities law. We cannot say that the District Court abused its equitable discretion by refusing to order additional injunctive relief.

E. Costs of the Derivative Suit

Finally, plaintiffs urge that the District Court erred in holding that plaintiffs had failed to establish a basis for reimbursement of their reasonable attorneys' fees and

[12]See note 6 supra.

expert witness fees incurred in maintaining this action. In Mills v. Electric Auto-Lite Co., 1970, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed. 2d 593,[13] the Supreme Court held that attorneys' fees could be awarded in private suits brought to enforce the Securities Exchange Act of 1934. The Court held that "petitioners, who have established a violation of the securities laws by their corporation and its officials, should be reimbursed by the corporation or its survivors for the costs of establishing the violation." Id., 396 U.S. at 389-90, 24 L.Ed.2d at 605.

We hold that the District Court erred in finding that plaintiffs had established no basis for reimbusemsnt of the costs of maintaining the derivative claim. By their efforts in acting as "private attorney generals," plaintiffs established violations of the securities laws and created a substantial fund for the benefit of IGB. The reimbursing of plaintiffs' costs for attorneys' fees and expert witness fees is supported both by the policy of encouraging enforcement of the securities laws and by well established equitable principles. "[P]rivate stockholders' actions of this sort 'involve corporate therapeutics,' and furnish a benefit to all shareholders by providing an important means of enforcement of the . . . statute. Id., 396 U.S. at 395 , 24 L.Ed.2d at 609 (footnotes omitted). Moreover. in the instant suit plaintiffs have created a substantial fund benefitting IGB, and plaintiffs are equitably entitled to be

[13]For a valuable discussion of the ramifications of Mills v. Electric Auto-Lite Co., see Comment, The Allocation of Attorney's Fees After Mills v. Electric Auto-Lite Co., 38 U. Chi. L. Rev. 316 (1971). See also Comment, Attorneys' Fees in Shareholder Derivative Suits: The Substantial Benefit Rule Reexamined, 60 Calif. L. Rev. 164 (1972); Note, Mills v. Electric Auto-Lite Company; Proxy Violations — The Causation Question and the Award of Attorney's Fees, 65 Nw. U. L. Rev. 854 (1970).

reimbursed by IGB. Sprague v. Ticonic Nat'l Bank, 1939, 307 U.S. 161, 83 L.Ed. 1184; Central R.R. & Banking Co. v. Pettus, 1885, 113 U.S. 116, 55 S.Ct. 387, 28 L.Ed. 915, Trustees v. Greenough, 1882, 105 U.S. 527, 26 L.Ed. 1157. On remand, the District Court should determine the amount of attorneys fees and expert witness fees reasonably incurred by plaintiffs in maintaining the derivative claims on behalf of IGB, and the Court should order IGB to reimburse plaintiffs in that amount.

V. CONCLUSION

Both in the District Court and in this Court, plaintiffs have vindicated the rights of IGB by enforcing the federal securities laws. Both the policy of the federal securities laws and notions of fair play require that plaintiffs be reimbursed for the costs of maintaining IGB's derivative claim. The District Court conducted the trial below in an admirable manner and we have been greatly benefitted by its thoughtful and incisive rulings. We affirm it in all things but the denial of plaintiffs' attorneys' fees and expert witness fees. Costs to be taxed against defendants-appellees-cross appellants.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED WITH INSTRUCTIONS.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1972

No. 72-2534

D. C. Docket No. CA 71-258-CIV

J. WILLIAM WOLF, ET AL,
Plaintiffs-Appellants-Cross Appellees

versus

ROBERT R. FRANK, ET AL,
Defendants-Appellees-Cross Appellants

Appeal from the United States District Court for the Southern District of Florida

Before RIVES, GOLDBERG and MORGAN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part; and that this cause be, and the same is hereby remanded to the said District Court with instructions in accordance with the opinion of this Court;

It is further ordered that defendants-appellees-cross appellants pay to plaintiffs-appellants-cross appellees the costs on appeal to be taxed by the Clerk of this Court.

April 24, 1973

Issued as Mandate:

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 72-2534

J. WILLIAM WOLF, ET AL,
Plaintiffs-Appellants-Cross-Appellees,

versus

ROBERT R. FRANK, ET AL,
Defendants-Appellees Cross-Appellants,

Appeal from the United States District Court for the Southern District of Florida

(Filed May 16, 1973)

Before RIVES, GOLDBERG and MORGAN, Circuit Judges.

BY THE COURT:

IT IS ORDERED that defendants'-appellees'-cross appellants' [hereinafter "appellees"] motion to require plaintiffs-appellants-cross appellees [hereinafter "appellants] to reimburse appellees for costs advanced by appellees in the amount of $773.80 is hereby DENIED; and IT IS FURTHER ORDERED that appellants' motion to require appellees to reimburse appellants' reasonable attorneys' fees incurred in defending against appellees' motion is hereby DENIED.

IT IS FURTHER ORDERED that appellants' motion that Industrial Guaranty Bancorp [hereinafter "IGB"] be required to reimburse appellants for the reasonable costs of attorneys' fees incurred in prosecuting and defending the appeal and cross appeal in the above numbered and styled case is hereby GRANTED to the extent that such costs were incurred in prosecuting and defending the appeal and cross appeal derivatively on behalf of IGB. On remand, the District Court should determine the amount of attorneys' fees incurred by appellants in prosecuting and defending this appeal and cross appeal on behalf of IGB, as well as the amount of attorneys' fees and expert witness fees incurred by appellants in maintaining the derivative claims of IGB at trial, and the Court should order IGB to reimburse appellants in that amount. *See Wolf v. Frank*, 5 Cir. 1973, slip op. no. 72-2534, pp. 24-25 (April 24, 1973).

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 72-2534

J. WILLIAM WOLF, ET AL,
Plaintiffs-Appellants-Cross Appellees,

versus

ROBERT R. FRANK, ET AL,
Defendants-Appellees-Cross Appellants.

Appeals from the United States District Court for the Southern District of Florida

ON PETITION FOR REHEARING AND PETITION FOR REHEARING EN BANC

(Opinion April 24, 1973, 5 Cir., 1973, ____ F.2d ____).

(June 5, 1973)

Before RIVES, GOLDBERG and MORGAN, Circuit Judges.

PER CURIAM: The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the Petition for Rehearing En Banc is DENIED.

A. 31

United States Court of Appeals

FIFTH CIRCUIT

EDWARD W. WADSWORTH
CLERK

OFFICE OF THE CLERK

600 Camp St. - Rm. 10
New Orleans, La. 7013

June 18, 1973

Mr. Irving M. Wolff
Attorney at Law
916 Biscayne Bldg.
Miami, Florida 33130

No. 72-2534 - J. William Wolf, Et Al vs.
Robert R. Frank, Et Al
(D. C. No. CA 71-258-Civ.)

MANDATE STAYED TO: July 18, 1973 ONLY

Dear Sir:

The court has this day granted a stay of the issuance of the mandate to the date as shown above. If during the period of the stay there is filed with the clerk of this court a notice from the clerk of the Supreme Court that the party who has obtained the stay has filed a petition for the writ in that court, the stay shall continue until final disposition by the Supreme Court. Upon the filing of a copy of an order of the Supreme Court denying the petition for writ of certiorari the mandate shall issue immediately under Rule 41, FRAP.

Under revised Rule 21(1) of the Supreme Court effective July 1, 1970, a record is no longer required in connection with an application for writ of certiorari, and therefore will not be routinely prepared by this office (38LW 3502).

Enclosed is a copy of the opinion, judgment and order denying rehearing which are still required by the Supreme Court to be incorporated as an appendix to your petition.

Very truly yours,

EDWARD W. WADSWORTH, Clerk

By Marquette K. Farley
Deputy Clerk

enc.

cc: Mr. Richard B. Marx
Mr. Howard W. Mazloff
Mr. Eugene C. Heiman

A. 33

United States Court of Appeals
FIFTH CIRCUIT

EDWARD W. WADSWORTH
CLERK

OFFICE OF THE CLERK

NEW ADDRESS
600 CAMP STREET
ROOM 400-600 ROYAL ST.
NEW ORLEANS, LA. 70130
TEL. NO. 527-6514

July 13,1973

MEMORANDUM TO COUNSEL OR PARTIES LISTED BELOW:

No. 72-2534 - J. William Wolf, Et Al vs.
Robert F. Frank, Et Al

Gentlemen:

The following action has this day been taken in the above case:

( ) Motion to consolidate granted.

( ) Motion to supplement or correct record granted.

( ) Motion for leave to file supplemental brief granted.

(X) A further stay of mandate has been granted to and including July 28, 1973

( ) The Court's opinion-order on petition for rehearing and petition for rehearing en banc has this day been rendered and a copy thereof is enclosed.

( ) Joint Motion as to time for filing briefs granted.

( ) Order enclosed has been entered.

( )

Very truly yours,
EDWARD W. WADSWORTH, Clerk

By Maryette Farley
Deputy Clerk

/mkf
cc: Mr. Richard B. Marx
Mr. Irving M. Wolff
Mr. Howard W. Mazloff
Mr. Eugene C. Heiman

HEREINAFTER APPEARS PERTINENT PORTIONS OF PLEADINGS AND ORDERS FILED AND ENTERED IN THE DISTRICT COURT PROCEEDINGS, OMITTING TITLES AND FORMAL PORTIONS.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

SECOND AMENDED COMPLAINT

Filed July 1, 1971

AS TO ALL COUNTS

Plaintiffs, J. WILLIAM WOLF, sometimes known as J. W. WOLF or JAKE WOLF, and PEARL M. WOLF, sometimes knows as PEARL WOLF, individually, and derivatively for the shareholders of INDUSTRIAL-GUARANTY BANCORP, a Florida corporation, sue the defendants, ROBERT R. FRANK, (FRANK), JACK H. STEIN, (STEIN), JOHN W. ROBERTS, JR., (ROBERTS), individually, and as purported trustees under a Voting Trust Agreement dated June 2, 1969, relating to the issued shares of INDUSTRIAL-GUARANTY BANCORP, a Florida corporation; and INDUSTRIAL-GUARANTY BANCORP, a Florida corporation, (INDUSTRIAL), and each of them and for grounds say:

1. The matter in controversy exceeds the sum or value of TEN THOUSAND ($10,000.00) DOLLARS, exclusive of interest and costs.

2. Plaintiffs are citizens of the State of New Jersey; defendants FRANK, STEIN and ROBERTS are citizens of the State of Florida; the corporate defendants are Florida corporations having their principal place of business in this District.

3. This action arises under Rule 10 b 5, adopted by the United States Securities and Exchange Commission pursuant to Section 10(b) of the Securities Exchange Act of 1934 (15 USC, Section 78(j); and Section 5 of the Securities Act of 1933 (15 USC, Section 77(e)). Jurisdiction of the claim under Rule 10 b 5 is vested in this Court by virtue of Section 27 of the Securities Exchange Act of 1934, 15 USC 78 aa; jurisdiction of the claim under Section 5 of the Securities Act of 1933 is vested in this Court by virtue of Section 22 of the Securities Act of 1933, 15 USC 77 (v).

4. At all material times, FRANK, STEIN and ROBERTS were the directors of INDUSTRIAL, and were the sole or principal officers of INDUSTRIAL, and were controlling persons of INDUSTRIAL as defined in Section 15(g) of the Securities Act of 1933, 15 USC 77(o). The liability asserted herein against the defendants, FRANK, STEIN and ROBERTS for the violation of Section 5 of the Securities Act of 1933 is based upon the liability of controlling persons specified in Section 15 of such Act. The liability of the individual defendants for the violation of Rule 10 b 5 arises from their individual activity in connection with the sale of stock in INDUSTRIAL alleged herein. The liability of the individual defendants asserted derivatively arises from their actions as the controlling persons and officers and directors of INDUSTRIAL.

5. At all material times, plaintiff J. WILLIAM WOLF was the agent of plaintiff PEARL M. WOLF, who was then his wife, acting within the scope of his authority.

6. During early 1969, in this District, plaintiffs and FRANK, STEIN and ROBERTS were negotiating a purchase by plaintiffs of shares of capital stock in INDUSTRIAL. The negotiations between plaintiffs and defendants and the subsequent sale of shares of stock in INDUSTRIAL to plaintiffs were part of a continuing distribution of securities of INDUSTRIAL, the last sale or distribution of which occurred less than one year prior to the filing of this action. No registration statement covering such securities of INDUSTRIAL has become effective or has been filed with the United States Securities and Exchange Commission. During the course of the negotiations between the defendants and plaintiff defendants represented to plaintiff that an application for approval of INDUSTRIAL as a bank holding company had been submitted to the Board of Governors of the Federal Reserve Board, and approval of the application was expected within the next six (6) months, and that a registration statement covering the shares of stock to be purchased by plaintiff had been filed with the Florida Securities Commission. Defendants represented to plaintiff that upon approval of the application of INDUSTRIAL by the Board of Governors of the Federal Reserve Board and effectiveness of the registration statement filed with the Florida Securities Commission the stock to be purchased by plaintiff would be freely tradeable and not subject to any restrictions. After plaintiff purchased his stock and continuing thereafter plaintiff was advised by defendants that approval of the Federal Reserve Board and the Florida Securities Commission would be forthcoming. Defendants further represented to plaintiff that upon approval by the Board of Governors of the Federal Reserve Board and the Florida Securities Commission an offering of INDUSTRIAL stock would be made at $5.00 a share.

By virtue of the misrepresentations made and continuing representations made to lull plaintiff into a false sense of security by believing that the shares purchased by him would be freely tradeable, defendants are estopped by their conduct from claiming the availability of the statute of limitations contained in Section 13 of the Securities Act of 1933.

7. During early 1969, at the times and places above mentioned, FRANK, STEIN and ROBERTS orally represented to plaintiffs that said defendants were the duly appointed and acting voting trustees pursuant to a Voting Trust Agreement executed by each of the shareholders of INDUSTRIAL.

8. At the times and places above mentioned, FRANK, STEIN and ROBERTS falsely and fraudulently orally represented to plaintiffs that:

8.1 The initial purchasers of securities in INDUSTRIAL were limited in number to fifteen (15) persons.

8.2 Each of said purchasers would pay Two ($2.00) Dollars per share, that said sums would be paid in cash at or about the date of the acquisition of the shares, and that neither FRANK, STEIN or ROBERTS, individually or as trustees, or any officers or directors would receive any salaries, expense accounts or allowances nor would any of such persons draw down any other sums from INDUSTRIAL.

8.3 FRANK, STEIN and ROBERTS, as trustees under said Voting Trust, then controlled National Indus-

trial Bank of Miami, a bank chartered under the laws of the State of Florida.

8.4 An application for approval of INDUSTRIAL as a bank holding company had been submitted to the Board of Governors of the Federal Reserve Board, and approval of the application was expected within the next six months.

8.5 An application for approval of INDUSTRIAL as a bank holding company had been submitted to the State of Florida, and approval of the application was expected within the next six months.

8.6 Upon approval of INDUSTRIAL as a bank holding company, the shares to be issued to plaintiffs and the other fifteen (15) initial shareholders would be freely tradeable "public" stock.

8.7 As trustees under the said Voting Trust, FRANK, STEIN and ROBERTS had entered into a contract to purchase one hundred percent (100%) of the outstanding stock of Citizens Bank and Trust Company of Sarasota, a bank chartered under the laws of the State of Florida.

8.8 As trustees under the said Voting Trust, FRANK, STEIN and ROBERTS had entered into a contract to purchase a controlling interest in Guaranty Bank of Miami, a bank chartered under the laws of the State of Florida.

8.9 The purchase of the above described banks would be accomplished by utilizing the proceeds of the sale

of shares in INDUSTRIAL, including plaintiffs' shares, and that, as trustees under the said Voting Trust, FRANK, STEIN and ROBERTS would then exchange the shares in the said banks acquired in this manner for shares in INDUSTRIAL so that the trustees under the Voting Trust would own a controlling interest in INDUSTRIAL.

8.10 As a result of the acquisitions set forth above, the value of the shares of INDUSTRIAL to be purchased by plaintiffs and the other 14 initial purchasers would go up in a public trading market.

9. At or about the times and places mentioned above, defendants made many of the same or similar representations to plaintiffs in writing, copies of which were attached to the original complaint as Exhibits "A" and "B". The two financial statements and the Voting Trust Agreement referred to in Exhibits "A" and "B" were attached to the complaint as Exhibits "C", "D" and "E" respectively.

10. At or about the times and places above mentioned, defendants delivered or caused to be delivered to plaintiffs a pro forma financial statement of INDUSTRIAL, copy of which is attached to the complaint as Exhibit "F".

11. At all material times FRANK, STEIN and ROBERTS, as officers and directors of INDUSTRIAL, impliedly represented to the plaintiffs that they would deal honestly and fairly with INDUSTRIAL, its assets and the stockholders of INDUSTRIAL, including plaintiffs.

12. The representations so made by the defendants were false and fraudulent, and in truth and in fact:

12.1 The initial purchasers of securities in INDUSTRIAL exceeded 15 persons.

12.2 Each of said purchasers did not pay $2.00 per share in cash at or about the date of the acquisition of their shares, and to the contrary, plaintiffs believe that FRANK, STEIN and ROBERTS did not pay such sums under such conditions. FRANK, STEIN and ROBERTS utilized assets of INDUSTRIAL to provide themselves with automobiles and like expense allowances.

12.3 FRANK, STEIN and ROBERTS did not at said times and places control National Industrial Bank of Miami as trustees under said Voting Trust.

12.4 Approval of the application of INDUSTRIAL as a bank holding company by the Board of Governors of the Federal Reserve Board could not have been reasonably expected within six months.

12.5 Approval of the application of INDUSTRIAL as a bank holding company by the State of Florida could not have been reasonably expected within six months.

12.6 Upon approval of INDUSTRIAL as a bank holding company, the shares to be issued to plaintiffs would not have been freely tradeable public stock.

12.7 As trustees under the said Voting Trust, FRANK, STEIN and ROBERTS had not entered into a contract to purchase 100% of the outstanding stock of Citizens Bank and Trust Company of Sarasota.

12.8 As trustees under the said Voting Trust, FRANK, STEIN and ROBERTS had not entered into a contract to purchase the controlling interest in the Guaranty Bank of Miami.

12.9 The purchase of interest in the Citizens Bank and Trust Company of Sarasota and National Industrial Bank of Miami were not accomplished by utilizing the proceeds of the sale of shares of INDUSTRIAL, nor did FRANK, STEIN and ROBERTS subsequently exchange the shares in said banks for shares in INDUSTRIAL.

12.10 No public trading market for the shares in INDUSTRIAL was ever established.

12.11 In addition, plaintiffs believe and therefore allege that the defendants, contrary to their fiduciary duty to the plaintiffs and other shareholders, and in contravention of their implied representations and warranties to deal fairly with the corporate assets, have misappropriated corporate assets in excess of FIVE HUNDRED THOUSAND ($500,000.) DOLLARS by borrowing said sums personally and causing INDUSTRIAL to participate in a loan owing to National Industrial Bank of Miami by Mark Anthony Drug Co., Inc., a Florida corporation, which loan was then in default or was not reasonably expected to be paid. Mark Anthony Drug Co., Inc., was at all material times owned or controlled by Don Mancino, a shareholder in INDUSTRIAL. FRANK, STEIN and ROBERTS were at all material times either officers, directors or substantial shareholders in National Industrial Bank of Miami. Defendants purchased municipal bonds from shareholders in INDUSTRIAL other than plaintiffs, for a sum in ex-

cess of FOUR HUNDRED THOUSAND ($400,000.) DOLLARS, granting such shareholders (which plaintiffs believe include FRANK, STEIN and ROBERTS) an option to redeem said municipal bonds at cost until December 31, 1973, while at the same time permitting said shareholders to receive the interest income earned by said bonds. Plaintiffs believe, and therefore allege, that the 19,826 common shares of National Industrial Bank acquired by INDUSTRIAL were acquired from FRANK, STEIN and ROBERTS or some of them without that fact having been disclosed to plaintiffs or other shareholders similarly situated. Defendants caused INDUSTRIAL to borrow from banks a sum in excess of ONE MILLION EIGHT HUNDRED TWENTY THOUSAND ($1,820,000.) DOLLARS and pledged as security for that loan 83,795 shares of Citizens Bank and Trust Company of Sarasota and THREE HUNDRED THOUSAND ($300,000.) DOLLARS in market value of said municipal bonds, which pledged assets were all or substantially all of the assets of INDUSTRIAL at the time of the making of said loan, without obtaining stockholder approval.

13. Defendants omitted to state material facts set forth in Paragraph 12, et seq, which facts were required to be stated, or necessary to make the statements made not misleading.

14. The financial statement attached as Exhibit "F" to the complaint was materially misleading in that same overstated assets and understated liabilities of INDUSTRIAL, and was misleading in that it was a pro forma statement of the assets and liabilities purportedly giving effect to uncompleted transactions and not a statement of actual assets and liabilities.

15. Plaintiffs, at the same time the representations were made, believed them, had no knowledge of the omissions, and in reliance upon such representations were induced to purchase 37,500 shares of stock for SEVENTY FIVE THOUSAND ($75,000.) DOLLARS, of which plaintiffs now own 14,000 shares of INDUSTRIAL.

16. Subsequent thereto, and during middle 1970, in furtherance of the fraudulent scheme set forth herein, defendants issued and delivered to plaintiffs the financial statement attached to the complaint as Exhibit "G". The financial statement (Exhibit "G") was materially misleading in that same overstated assets and understated liabilities of INDUSTRIAL, and was misleading in that it was a pro forma statement of the assets and liabilities purportedly giving effect to uncompleted transactions and not a statement of actual assets and liabilities.

17. Plaintiffs will fairly and adequately represent the interests of all other shareholders of INDUSTRIAL. Plaintiffs were shareholders of INDUSTRIAL at the time of the transactions of which they complain; this action is not a collusive action to confer jurisdiction on a court of the United States; plaintiffs have not made any efforts to obtain the action they desire from the directors for the reason that such efforts would be unavailing in that at all material times FRANK, STEIN and ROBERTS were the sold directors and principal officers of INDUSTRIAL, and such persons participated in, approved, or were the beneficiaries of the wrongful acts or conduct herein alleged; such persons have for a considerable time been aware of the wrongful acts and conduct alleged herein but failed to take action thereon; that prior to January 29, 1971, no meetings of stockholders for election of directors or other-

wise, or if such meetings were held, plaintiffs were not given notice of such meetings by defendants despite the fact that plaintiffs residence and business addresses were well known to the defendants or by the exercise of reasonable diligence should have been known. Shortly prior to January 29, 1971,[plaintiffs learned from another source that a stockholders' meeting of INDUSTRIAL had been scheduled in this District. Defendants had not given plaintiffs notice of the pendency of this meeting. Plaintiffs sought to attend said stockholders' meeting with counsel, but despite the fact that FRANK is an attorney at law duly licensed to practice in Florida, plaintiffs counsel was not permitted to attend the meeting and plaintiffs were deprived of the advice of counsel at the meeting. At the meeting plaintiffs requested copies of the Minutes of stockholder and other stockholder meetings, if any, director meetings, if any, and the By-Laws of INDUSTRIAL. Despite the fact that said documents were promised by defendants to be furnished promptly to plaintiffs, defendants have failed and refused to provide plaintiffs with a copy of said documents. At all material times FRANK, STEIN and ROBERTS claimed to own in excess of 534,000 shares of the stock of INDUSTRIAL, more than one-third (1/3) of the issued shares.

18. Plaintiffs have employed HEIMAN and CRARY, P.A., as their attorneys and have agreed and obligated themselves to pay said attorneys a reasonable attorneys' fee.

19. The purchase of the stock of INDUSTRIAL by defendants was accomplished through and by means and instrumentalities of interstate commerce and the United States mails, to-wit:

19.1 Plaintiffs mailed check for payment of the purchase price from New Jersey to Miami, Florida.

19.2 The stock certificates were mailed to defendants from Miami to New Jersey.

19.3 Checks given in payment were cleared through the Federal Reserve System, an instrumentality of interstate commerce.

20. All conditions precedent to the bringing of this action have been performed or have occurred.

COUNT I

21. The misrepresentations, omissions and acts alleged herein constituted a manipulative and deceptive device and contrivance and a scheme and artifice to defraud in connection with the sale of securities of INDUSTRIAL to plaintiffs in contravention of Rule 10 b 5, adopted by the United States Securities and Exchange Commission pursuant to Section 10(b) of the Securities Exchange Act of 1934 (15 USC Section 78(j)).

COUNT II

22. Sale by plaintiffs to defendants of the stock of INDUSTRIAL constituted a violation of Section 5 of the Securities Act of 1933, in that no registration statement covering said securities had been declared effective by the United States Securities and Exchange Commission and such sale by defendants to plaintiffs was accomplished through and by means and instrumentalities of Interstate Commerce and United States Mails.

COUNT III

23. As a result of the fraudulent representations, omissions and acts of the defendants alleged herein, plaintiffs individually and derivatively have been damaged in a sum in excess of TEN THOUSAND ($10,000.) DOLLARS exclusive of interest and costs.

24. The said representations were known by the defendants to be false when made, and the omissions were intentionally omitted by the defendants and were made with the intent to deceive plaintiffs and to induce plaintiffs to purchase the said shares in INDUSTRIAL.

WHEREFORE, plaintiffs pray:

25. That the Court preliminarily, and permanently, enjoin the defendants, their agents, servants, employees and attorneys and all persons in active concert and participation with them from utilizing any funds of INDUSTRIAL for any purposes other than acquisition of controlling interest in the banks described in the representations herein.

26. That a receiver of the property, rights and goodwill of INDUSTRIAL be appointed with power to collect all debts for the profit of all parties entitled thereto, and to conserve the assets of INDUSTRIAL.

27. That an accounting be taken of all of the dealings and transactions from the commencement of business of INDUSTRIAL and of monies received and paid by the defendants respectively in relation thereto, and of the transactions to which INDUSTRIAL was a party.

28. That the assets of INDUSTRIAL utilized and employed by the defendants for their personal business and use be declared and found to constitute a trust fund for the benefit of INDUSTRIAL and its innocent shareholders and that the defendant be required to account therefore and the profits therefrom.

29. That the shares of stock issued by INDUSTRIAL to defendants for any consideration less than $2.00 cash per share be cancelled on the books of INDUSTRIAL and that the defendants and all persons deriving title to said shares by, through or under them be required to return and surrender the certificates evidencing said shares to INDUSTRIAL for cancellation, or alternatively that an equitable lien be impressed on any share directly or indirectly owned by defendants to secure any sums due plaintiffs individually and derivatively.

30. That the plaintiffs individually and derivatively recover compensatory damages from the defendants in a sum in excess of TEN THOUSAND ($10,000.) DOLLARS, exclusive of interest and costs, besides costs and reasonable attorneys' fees.

31. That plaintiffs individually and derivatively recover for such other and further relief as may be just and proper.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

ANSWER TO SECOND AMENDED COMPLAINT AND AFFIRMATIVE DEFENSES

Filed September 24, 1971

The Defendants INDUSTRIAL GUARANTY BANCORP., JOHN W. ROBERTS, JR., JACK H. STEIN and ROBERT R. FRANK file this their Answer to the Second Amended Complaint.

1. Defendants deny each and every allegation of the Second Amended Complaint, unless specifically admitted.

2. Defendants deny each and every allegation contained in Paragraphs 1, 2, 3, 5, 6, 7, 8, 9, 10, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23 and 24.

3. As to Paragraph 4, the Defendants ROBERT R. FRANK, JACK H. STEIN and JOHN W. ROBERTS, JR. admit that they were Directors and Officers of INDUSTRIAL GUARANTY BANCORP., however, deny each and every remaining allegation in said Paragraph.

4. The Defendants, ROBERT R. FRANK, JACK H. STEIN and JOHN W. ROBERTS, JR., as Officers and Directors of INDUSTRIAL GUARANTY BANCORP., admit the allegation in said Paragraph.

AFFIRMATIVE DEFENSES

1. That the Plaintiff's Actions, to-wit: the re-sale of approximately 23,000 shares of the stock purchased by

him to at least twelve individuals in various states of the United States other than Florida, at prices ranging from $2.00 to in excess of $4.00, at the time he was purchasing the stock for $2.00 per share, was in violation of the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. In addition, the Plaintiff entered into illegal arrangements with the purchasers, by guaranteeing them that, if they purchased the stock, they would not lose money. These activities place the Plaintiff in pari delicto with the Defendants, and, further, creating a situation whereby he has attempted to enlist the aid of a Court of equity, while he himself comes into said Court with unclean hands.

2. The Plaintiff has not only suffered no damage as a result of the purchase of the stock in question, but has, in fact, profited by purchasing the stock at $2.00 per share and immediately re-selling it to others at prices in excess of $4.00 per share.

3. That the Plaintiff's claim is clearly barred as a matter of Law, by the Statute of Limitations contained in Section 13 of the Securties Act of 1933.

4. That the Plaintiff has failed to comply with the requirements of Section 12 of the Securities Act of 1933, in that he has failed to tender his securities to the Defendant Corporation, or, in the alternative, to set forth any predicate for damages.

5. That the stock sold by the Defendant INDUSTRIAL GUARANTY BANCORP. was exempt from the registration provisions of the Securities Act of 1933, by virtue of the exemptions in said Act.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

MOTION FOR JUDGMENT ON THE PLEADINGS

Filed December 22, 1971

Defendants Move this Honorable Court, pursuant to Rule 12(c) of the Federal Rules of Civil Procedure, for a Judgment on the Pleadings, and as grounds for said Motion submit as follows:

1. Plaintiffs' Complaint is predicated upon a violation of Section 5 of the Securities Act of 1933 and, also, Rule 10(b)(5) of the Securities Exchange Act of 1934.

2. The Pleadings in this case clearly show that the Section 5 violation is barred by the Statute of Limitations which is set forth in Section 13 of the Securities Act of 1933. Further, the Section 5 violation is barred, on its face, by the fact that Sections 3 and 4 of said Act exempt certain transactions, and kinds of securities, from the effect of Section 5.

3. The alleged derivative claim, under Rule 23.1, is clearly defective as has been demonstrated by the Plaintiff, J. WILLIAM WOLF, in his Answer to Interrogatories wherein he admits, in effect, only representing his own interest. Said Plaintiff has previously asserted, under oath, that he was representing other stockholders. It would appear that the conduct of Plaintiff, J. WILLIAM WOLF, in this Case prohibits him from meeting the standard of conduct required in said Rule.

4. Plaintiffs have been guilty of coming into an Equity Court with unclean hands, and have, in fact, engaged themselves in a series of illegal Stock transactions involving the subject securities, which would, in fact, prohibit them from representing others.

5. Irrespective of all of the foregoing, Plaintiffs claim is clearly barred by the fact that they have not demonstrated any basis for this Court assessing damages. The fact remains that the Plaintiffs received a monitary profit from their dealings in these securities, and, therefore, there can be no basis for recovery.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

ORDER ON MOTION FOR JUDGMENT ON THE PLEADINGS

Filed February 16, 1972

THIS CAUSE is before the Court on defendants' motion for judgment on the pleadings, which has been treated in part as a motion for summary judgment pursuant to Rule 12(c), F.R.C.P. The motion has been briefed and argued at length. Since one of the problems with the several motions to dismiss and motions for summary judgment in this case has been the general references to the complaint, without specifying the particular claim referred to, I will deal separately with the six claims for relief presented by plaintiffs.

Plaintiffs assert claims, individually and derivatively, under §12 of the Securities Act of 1933 for violation of §5, under §10b of the Securities Exchange Act of 1934 and Rule 10b-5, and for common law fraud, breach of fiduciary duty and waste of corporate assets, with diversity of citizenship as a jurisdictional basis. Defendants argue that none of these claims can be sustained, because plaintiffs have suffered no cognizable damages. It is uncontradicted that plaintiff Wolf purchased 37,500 shares of IGB stock at $2.00 a share, and that he resold all but 14,000 of these shares, on separate occasions, for $96,550.00, realizing a profit. Plaintiff argues that he orally guaranteed those who purchased from him against

loss, and that the potential loss on these guarantees constitutes a cognizable element of damages.

Without relying upon defendants' thesis that these guarantees would be unenforceable against plaintiff Wolf because not in writing as required by the statute of frauds, it seems clear that these speculative "damages" cannot form a basis for relief. Under any analysis, they would not be proximately caused by the alleged wrongful conduct of defendants. Any such loss would be attributable to plaintiff's unforseen, intervening, and perhaps unlawful, act of reselling his stock and guaranteeing a profit to those who purchased from him.

As noted in Mott v. Tri-Continental Financial Corp., 330 F.2d 468, 471 (2d Cir. 1964), a plaintiff who owns no shares is not entitled to §12 relief where he has resold at a profit: "Since Mott no longer owns the Commonwealth shares he is limited to an action for damages and may not be accorded rescission. As Mott can show no loss he has no cause of action under the statute." Plaintiff Wolf's individual claim under §12 must therefore be dismissed unless by amendment to his complaint, within three days from entry of this order, he seeks rescission. The alternative rescission remedy has been referred to in plaintiffs' memoranda, although never pled. Accordingly, defendants would not be prejudiced by such an amendment.

Any derivative claim under §12 is defective since injury to the corporation is the prime requisite for such a claim. Polakoff v. Delaware Steeplechase & Race Association, 254 F.Supp. 574 (D. Del. 1966). §12 affords a remedy to the purchaser alone where there has been noncompliance

with §5. It is not argued that the §5 violation alleged here resulted in injury to the issuer. Accordingly it is ORDERED AND ADJUDGED that the §12 claim, asserted derivatively, is dismissed.

The common law fraud and mismanagement claims, both individual and derivative, are properly before the Court since diversity of citizenship and pendent jurisdiction exist. Pendent jurisdiction can be found because of the common nucleus of operative fact between the federal and state claims. Boggess v. Hogan, 328 F.Supp. 1048, 1053 (N.D. Ill. 1971). While it is not asserted in so many words in the complaint, the defendants have not contested the existence of complete diversity, and did not do so at oral argument. The motion for summary judgment as to the fraud claims is therefore denied.

As to the Rule 10b-5 derivative claim, defendants correctly argue that the corporation, to sustain recovery on its behalf, must have been either a purchaser or a seller of securities. The Birnbaum doctrine, in the Fifth Circuit at least, is said in the words of "Invictus" to be "bloody, but unbowed." Rekant v. Desser, 425 F.2d 872, 877 (5th Cir. 1970); Dudley v. Southeastern Factor and Finance Corp., 446 F.2d 303 (5th Cir. 1971). Defendants are also correct in stating that alleged breaches of fiduciary duty do not create 10b-5 claims, but merely claims cognizable under state law. See, e.g., Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969); Erling v. Powell, 429 F.2d 795, 800 (8th Cir. 1970).

In the case sub judice, however, plaintiffs assert that the facts adduced at trial will show that this case is

governed by the holding of Rekant v. Desser, supra, that a derivative action could be maintained against corporate officers and directors who fraudulently caused the corporation to issue treasury shares and a note to them "for grossly inadequate consideration." Plaintiffs' allegations outline similar transactions. These allegations are sufficient to withstand attack.

Resolution of the challenge to plaintiffs' individual Rule 10b-5 claim, in light of the profit which has been made on resale of part of their holdings, presents more difficult issues. Plaintiffs argue that, given the alleged violations of the 1934 act, the resultant dilution of their equity in IGB constitutes a cognizable legal injury. Swanson v. American Consumer Industries, Inc., 415 F.2d 1326, 1332 (7th Cir. 1969) supports this view. Cf. Boggess v. Hogan, 328 F.Supp. 1048 (N.D. Ill. 1971).

Under Birnbaum, plaintiffs are of course purchasers of IGB stock. The alleged dilution, though, resulted from the issuance, or sale, of corporate stock to insiders for allegedly inadequate consideration. Plaintiffs were not, as to this transaction, purchasers or sellers. In most other respects, plaintiffs' allegations of breach of fiduciary duty do not state a 10b-5 claim for relief. Schoenbaum v. Firstbrook, supra; Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967).

In effect, plaintiffs allege fraud in connection with the purchase by them of IGB stock. The specific element of damages on which they rely to resist entry of summary judgment against them, however, resulted from a transaction in which they took no part, i.e., the issuance of IGB shares to defendants upon which the derivative 10b-5

claim is based. My feeling is that these questions of damages should await resolution at trial, where any interrelationship between the allegedly fraudulent transactions can be developed. The equitable relief sought by plaintiffs also militates against dismissal or summary judgment. Cf. Mutual Shares Corp. v. Genesco, Inc., supra, at 547.

Accordingly, it is further ORDERED that the defendants' motion as to the Rule 10b-5 claims is denied.

DONE AND ORDERED at Miami, Florida this 15th day of February, 1972.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

AMENDMENT TO PLAINTIFFS' SECOND AMENDED COMPLAINT

Filed February 18, 1972

Plaintiffs, J. WILLIAM WOLF, sometimes known as J. W. WOLF or JAKE WOLF, and PEARL M. WOLF, sometimes known as PEARL WOLF, hereby amend the Second Amended Complaint by adding to the prayer for relief, paragraph 32, which states as follows:

Additionally and alternatively, Plaintiffs pray:

32. That the sales of the shares of Industrial to Plaintiffs be rescinded and that the purchase price paid therefor be refunded in exchange for the stock

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

AMENDED ANSWER TO AMENDMENT TO SECOND AMENDED COMPLAINT

Filed March 3, 1972

The defendant INDUSTRIAL GUARANTY BANCORP (IGB), by and through its undersigned attorneys, hereby amends its answer heretofore filed and submits:

1. That at the time of the filing of the answer the defendant was agreeable to refunding the moneys represented by the 14,000 shares which the plaintiff owns.

2. In view of the fact that the plaintiff has renegged on his request for recision, the defendant now asserts the following affirmative defenses:

I.

The recision requested is barred by the statute of limitations.

II.

Recision is barred as the plaintiffs have failed to tender.

III.

The plaintiff's request is barred by reason of the plaintiff's inequitable conduct and bad faith in filing the suit and unclean hands throughout the proceedings.

IV.

The plaintiff is guilty of violations of Section 5 of the Securities Act of 1933 and is therefore in pari delicto.

V.

Restitution is unavailable to the plaintiff as the status quo cannot be realized in view of the plaintiff having sold most of the stock originally purchased. Recision and restitution are not available on a partial basis.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

ANSWER OF INDUSTRIAL GUARANTY BANCORP TO AMENDMENT TO PLAINTIFFS' SECOND AMENDED COMPLAINT

Filed March 8, 1972

The Defendant, INDUSTRIAL GUARANTY BANCORP. (IGB), by and through its undersigned Attorneys, in response to Amendment to Plaintiffs' Second Amended Complaint, Paragraph 32, states:

1. That Plaintiffs' request for refund and recission, filed the 17th day of February, 1972, is the first indication the Defendant has received that Plaintiffs wish the return of their money.

2. That the Defendant is ready, willing, and able to repay to the Plaintiffs the funds that they have paid to the Defendant for the Shares of capital stock in Defendant's Corporation. Defendant specifically denies any wrongdoing; however, feels that they do not wish to be associated with any disgruntled Stockholder.

3. That, had the Plaintiffs requested recission prior to the filing of the suit, or at any time during the course of these Proceedings, the Defendant, IGB, would have refunded all of the Plaintiffs' moneys.

4. That Plaintiffs did not file this suit in good faith, and have caused the Defendant to expend considerable funds for the defense of this action, and have wasted this Court's time with these Proceedings by their failure to seek recission prior to filing this suit.

5. That Defendant, IGB, is attaching a Cashiers Check made payable to JOSEPH I. BOGART, Clerk of Court, for release to Plaintiffs when they have delivered their Stock Certificates to IGB for refund in exchange for the purchase price paid therefor, to-wit: 14,000 Shares at $2.00 per share.

6. The record in this cause reflects that Plaintiffs own 14,000 Shares of IGB capital stock. Accordingly, Defendant, IGB, has deposited $28,000.00; however, Defendant, IGB, agrees to refund the purchase price, i.e., $2.00 per Share, for any additional Shares purchased by the Plaintiffs in the event the record is in error.

WHEREFORE, Defendant, IGB, prays that this Honorable Court confirm this acceptance of the Plaintiffs' request for recission, and Dismiss the Proceedings, with Costs to be taxed to the Plaintiffs.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Filed March 28, 1972

THIS CAUSE came on for non-jury trial before me on plaintiffs' complaint charging the defendants with violations of §5 of the Securities Act of 1933, §10(b) of the Securities Exchange Act of 1934, and Rule 10b-5, and common law fraud claims for breach of fiduciary duty and mismanagement, all asserted individually and derivatively. By an order entered February 15, 1972, I dismissed the derivative §12 claim, for violation of §5, since §12 by its nature provides relief for harm done to the purchasers of the unregistered stock, rather than for injury to the corporation.

At the close of plaintiffs' case, I dismissed plaintiffs' individual 10b-5 claims, based upon their failure to show any "actual damage" to them in connection with the purchase or sale of securities. 15 U.S.C. §78bb. Plaintiffs cannot recover their loss of anticipated profits under the applicable actual damages standard. Schaefer v. First National Bank of Lincolnwood, 326 F.Supp. 1186, 1193 (N.D. Ill. 1970). Plaintiffs' testimony made clear that this was the loss for which they individually sought recovery, having already turned a $20,000 profit on an out-of-pocket basis. The derivative 10b-5 claim withstood challenge under the umbrella of Rekant v. Desser, 425 F.2d 872 (5th Cir. 1970).

In addition to the evidence presented at trial, I have relied upon the pretrial stipulation and the further stipulation entered into at the beginning of the trial. The latter stipulation has been quite helpful, and has simplified a relatively complicated case.

FINDINGS OF FACT

1. The plaintiffs, J. William Wolf (plaintiff) and Pearl Wolf, are citizens of the State of New Jersey. Plaintiff is a former director, officer, member of loan committee and shareholder of Essex State County Bank in New Jersey.

2. The nominal defendant on whose behalf the derivative claims are asserted, Industrial-Guaranty Bancorp (IGB), is a Florida corporation with its principal place of business in Florida. The individual defendants, Robert R. Frank, Jack H. Stein, and John W. Roberts, Jr., are citizens of the State of Florida. At all relevant times they were officers and directors of IGB.

3. In early 1969, plaintiff began discussing with Stein and Frank a possible investment in IGB stock. Frank, an attorney, had represented a corporation in which plaintiff was a stockholder, and they met in that capacity.

4. Frank, Stein and Roberts were the organizers of IGB, which was created with the intention that it become a bank holding company. Those approached initially, concerning IGB, consisted of a group of business acquaintances with ties to the National Industrial Bank (NIB).

5. It is stipulated that the complained-of-activities were accomplished by the use of means and instrumentalities of interstate commerce and the mails.

6. Between early 1969 and the date of his initial purchase of IGB stock on July 10, 1969, and between that date and his final purchase on October 8, 1969, plaintiff met Frank, Stein and Roberts on numerous occasions to discuss the new company. Different combinations of defendants were present at the various meetings.

7. Before the July purchases, defendants Stein and Frank represented to plaintiff that they were going to allow a few of their friends—not more than 15 in number—to get into the deal before a proposed public offering by purchasing the IGB stock at $2 per share. They represented, in response to plaintiff's inquiries, that everyone would pay $2 cash per share, and that there would be no free stock or fringe benefits of any kind to anyone. While defendant Roberts was present at the time some of these representations were made, there is no credible evidence that he made any affirmative representations.

8. In reliance upon these and other representations concerning the application of IGB to the Federal Reserve Board for approval as a bank holding company, the acquisition plans of IGB, and the progress of registration of IGB shares with the Florida Securities Commission, plaintiffs purchased 37,500 shares of IGB for $75,000 between July 10, 1969 and October 8, 1969. No registration statement was then in effect as to those securities.

9. Plaintiff, as early as July 24, 1969, began inquiring among his friends about resales to them of the IGB

stock he had purchased. During the six month period beginning in late July, 1969 plaintiff sold at least 23,000 of his 37,500 shares to approximately fourteen persons in various parts of the United States at prices ranging from $2 to $5 per share. In these transactions plaintiffs realized $95,000—some $20,000 more than they paid for all of their IGB stock.

10. In fact, an application for approval as a bank holding company was never filed on behalf of IGB. The defendants acquired their stock interest in IGB for long term (3 years maturity), unsecured, non-interest bearing promissory notes and by exchanging other securities (NIB stock) then worth substantially less than the $2 per share value assigned to the IGB stock received in return.

11. In September, 1969 defendants exchanged 19,826 shares of NIB stock for 346,955 shares of IGB stock, pursuant to an exchange ratio computed by defendant Roberts. At the exchange value of $2 per share, this IGB stock was worth $693,910. (There is reliable evidence that the book value of the IGB stock was only $1.60 at the time.) The NIB stock which the corporation received in exchange was selling for $10 a share in October, 1969. Defendants had purchased it in January, 1968 for $198,260 or $10 a share. Under any measure of value, the NIB stock was greatly overvalued in the exchange.

12. On January 16, 1970, defendants received 184,935 IGB shares in exchange for non-interest bearing, unsecured promissory notes in the amount of $369,870, due in 1973.

13. The Certificate of Incorporation of IGB (Article III) requires the directors to fix the value of any property received by the corporation in exchange for stock. This was not done in conjunction with the transfer by the defendants of 19,826 shares of their NIB stock (for which they paid $10 per share) for 346,955 shares of IGB stock. In said exchange a ratio of 17½ to 1 was the basis used, and the value of the IGB stock was calculated at its par of $1 per share. Defendants admit they received the equivalent of $17.50 per share for their NIB stock. If the transaction had been based on payment of $2 per share for the IGB stock (as they represented and everyone else in fact did pay) they received what amounted to $35 per share for their NIB stock.

This required valuation was also neglected in connection with the issuance of stock to Ebaugh and Sackman (discussed infra) and the issuance of stock to defendants in exchange for their promissory notes.

14. The original capitalization of IGB consisted of 20,000 shares of common voting stock having a one cent par value. The defendants commenced offering IGB shares to persons other than the defendants as early as May 29, 1969. The stock in IGB was recapitalized to 6,000,000 shares of common voting stock having a $1 par value at a joint meeting of shareholders and directors held on July 3, 1969. The minutes and the certificate of IGB mailed to the Secretary of State of Florida indicated that the defendants were, on July 3, 1969, the only shareholders and directors.

15. Shortly following July 3, 1969, the defendants sold IGB stock to Murray Klepesch, who was not a Florida resident.

16. Defendants continued to offer to sell and to sell to other persons, and in fact, on April 13 and 21, 1970 sold 35,000 shares of IGB stock to David Weider, who was then a citizen of Ohio. On April 30, 1970, ten days following the Weider sale, defendants caused IGB to file an application for registration in Florida, relying on the intrastate offering exemption.

17. A votng trust agreement reflects that defendants controlled 1,336,391 voting shares. Defendants were, at all material times, in control of IGB.

18. At the same time that the notes of the defendants issued to IGB, in the amount of $369,870 (such notes being non-interest bearing and unsecured) were outstanding, IGB borrowed from banks greater sums, at interest rates varying from 7½% to 9½% per annum. Such loans were fully secured by part of the assets of IGB.

19. At the time Don Mancino borrowed money from IGB, he was a stockholder of IGB. Mancino was also the sole owner of Mark Anthony Drug Company, Inc. which had borrowed $50,000 from National Industrial Bank and defaulted on that loan. Mancino guaranteed that loan in writing. During this period, defendants were either officers, directors, or counsel to NIB. On September 23, 1969, while this loan from NIB was unpaid, IGB lent Mancino an additional $50,000 and took as security the shares of Mark Anthony, knowing them to be part of a speculative issue. Mancino defaulted on the IGB loan.

20. In June, 1969, Ebaugh and Sackman, who later became directors of IGB, purchased 250,000 shares of IGB

by transferring municipal bonds in the amount of $400,000 to IGB. This was done under an agreement whereby Ebaugh and Sackman were granted the right to receive the interest payable on such bonds after their transfer, and were granted an option to repurchase the bonds for the same amount at any time from January 1, 1970 thru December 31, 1973. Ebaugh also paid for a part of the stock with $120,000 of Treasury Bills due shortly thereafter. IGB used the bonds to obtain loans in the amount of their value from other banks. Ebaugh and Sackman agreed to reimburse IGB for such interest.

21. No annual or special meeting of stockholders had been held of which plaintiffs had received notice until January 21, 1971. Plaintiffs instituted this litigation soon after that meeting.

22. At a directors' meeting (held January 16, 1970) the defendants as directors elected Ebaugh, Sackman and Freeman as directors.

23. The newly constituted board of directors ratified defendants' exchange of securities for IGB stock. The new directors (Ebaugh, Sackman and Freeman), with the defendants abstaining, then authorized the defendants to purchase an additional 184,935 shares of IGB stock by executing the above non-interest bearing, unsecured notes. The newly constituted board then unanimously voted to ratify all actions taken by the defendants as directors on previous occasions.

CONCLUSIONS OF LAW

1. This Court has jurisdiction of the federal securities law claims, pursuant to 15 U.S.C. §§78aa and 77v, and of the state law claims, pursuant to 28 U.S.C. §1332 and pendent jurisdiction.

2. Plaintiffs are not barred from recovery by the unclean hands or in pari delicto defense. This defense is not favored in securities cases, 3 Loss, Securities Regulation 1694 (2d ed. 1961), and is not applicable on the facts of this case simply because of plaintiffs' resales. Can-Am Petroleum Co. v. Beck, 331 F.2d 371, 373 (10th Cir. 1964).

3. The derivative actions for violation of Rule 10b-5 and common law breach of fiduciary duty are properly maintained by plaintiffs. Some of the challenged transactions, however, such as the June 2, 1969 issuance of shares to Messrs. Ebaugh and Sackman for municipal bonds, cannot be asserted derivatively because of the contemporaneous ownership requirement embodied in Rule 23.1, F.R.C.P., and F.S.A. §608.131(1). Plaintiffs were not shareholders at the time of this alleged wrong.

4. Plaintiffs' §12 claim for violation of §5 of the Securities Act of 1933 is not barred by the one year statute of limitations contained in §13. This case is controlled by Katz v. Amos Treat, 411 F.2d 1046 (2d Cir. 1969), holding that a suit under §12(1) should not be dismissed, although brought more than a year after the stock sales in question, where defendant had constantly held out to plaintiff the prospect of an SEC registration. Here plaintiff instituted suit promptly after learning of the complete collapse of IGB's bank holding company and stock registration plans.

Defendants are estopped by their conduct, including continuing misrepresentations, from asserting the statute of limitations.

5. Plaintiffs, should they desire it (they amended their complaint to seek rescission relief alternatively, only if their other individual claims fail), are entitled to recover the consideration paid for the 14,000 IGB shares which they still hold with interest thereon, upon the tender to defendants of such securities, since they have established a violation of §5. The three elements set forth in Hill York Corp. v. American International Franchises, Inc., 448 F.2d 680, 686 (5th Cir. 1971) have been shown. Defendants have failed to carry their burden of showing the existence of a §4 private offering exemption. There was absolutely no showing that the offerees, by virtue of their relationship to the issuer or otherwise, had "access to the kind of information which registration would disclose." SEC v. Ralston Purina Co., 346 U.S. 119, 127 (1953). Indeed, the evidence adduced at trial disclosed the lack of access to such information. Similarly, no intrastate offering exemption was available or could reasonably have been relied upon.

This tender may be made to the individual defendants, who have violated §5 as controlling persons under §15 of the 1933 Act and are therefore liable under §12. They were also "the motivating force behind this whole project," and are therefore liable under §12(1) as persons who sold or offered to sell unregistered IGB stock. Hill York Corp. v. American International Franchises, Inc., supra, at 693. If such tender is made, it shall be done within seven days of the entry of these Findings and Conclusions and a written statement of that election filed in this cause within that time.

6. Plaintiffs have established a derivative Rule 10b-5 violation in the fraudulent issuance of stock to insiders for grossly inadequate consideration. The corporation was damaged in this transaction just as the corporation was in Rekant v. Desser, 425 F.2d 872 (5th Cir. 1970). The defendants received IGB stock valued at $693,910 in exchange for NIB stock reasonably valued at that time at $198,826. Thus they paid approximately 57 cents per share for the IGB stock then being distributed for $2 per share. Accordingly, the corporation is entitled to recover the following sums from the defendants: Stein ($1.43 × 173,477 shares) $248,072.11; Frank ($1.43 × 97,148 shares) $138,921.64; Roberts ($1.43 × 76,330 shares) $109,151.90.

7. As noted, supra, this transaction does not give rise to an individual 10b-5 claim by the plaintiffs. First, the plaintiffs were neither purchasers nor sellers of securities in regard to this stock purchase. As in Rekant, supra, at 879, there is no allegation that this fraud influenced their investment judgment. Plaintiff had already sold much of his stock at a profit. Had he known of the fraud worked upon the corporation, he certainly would not have been induced to keep the rest. Instead he probably would have done exactly what he continued to do, i.e., sell off his holdings.

8. There was adequate consideration for the issuance of stock to Messrs. Ebaugh and Sackman for municipal bonds and the officers and board of directors, in the exercise of their business judgment, could have so concluded. Accordingly there was no misrepresentation, omission, or fraud sufficient to create 10b-5 liability.

9. The same is true for the issuance of stock to the defendants for non-interest bearing, unsecured notes. Although highly irregular, there is no evidence that they will not be paid. One aspect of this transaction does, however, constitute a breach of the defendants' fiduciary duty to the corporation and its shareholders. The corporation should be reimbursed for the interest which the defendants caused it to relinquish. Accordingly, the defendants are liable to the corporation for interest on the amount of the notes ($369.870) at 7½% from January 16, 1970 to date.

10. Once these sums have been restored to the corporation, making it whole, there is no need to route the recovery to the minority shareholders, instead of the corporation. Perlman v. Feldman, 219 F.2d 173 (2d Cir. 1955) is not applicable to the case sub judice.

11. As to the state law claims, defendants' breach of fiduciary duty in connection with the issuance of stock to them is to be remedied as described above. No fraud has been shown in connection with the Mancino loan, as defined in Kutner v. Kalish, 173 So.2d 763 (Fla. App. 1965). Further, the mere fact that Don Mancino was a shareholder of IGB at the time of the loan is insufficient to establish a breach of fiduciary duty.

12. No damage has been shown as a result of defendants' failure to hold, or give notice of, shareholders' meetings.

13. Plaintiffs at trial also questioned an alleged deprivation of their preemptive rights. They concede in their proposed findings and conclusions that when all purchasers of IGB treasury stock have paid the equivalent of

$2 per share for the stock, then reinstatement of any preemptive rights of which plaintiffs have been deprived is unnecessary.

To dispel further any preemptive rights contention, the Court notes that the sales which plaintiffs seek to upset were not "for cash" as required by FSA §608.42(2). It also appears that the stock in question is not "new stock" as used in §608.42(2), since it was authorized on July 3, 1969. Prior to that date, the authorization was for only 20,000 shares. Since plaintiffs themselves acquired 37,500 shares subsequent to July 10, 1969, the plaintiffs apparently purchased the same stock (out of the same authorized and issued block) as the defendants and Ebaugh and Sackman. There has been no showing that those sales constituted a new issue, to which preemptive rights would attach. In fact, some of plaintiffs' purchases were after the defendants' purchases in exchange for NIB stock.

Finally, there is no reason to believe that, had these been cash sales for $2 per share, plaintiffs would have exercised preemptive rights. They seek in this litigation to dispose of their remaining shares. At the time of the challenged transactions, plaintiffs were actively disposing of their IGB stock. The evidence also shows that plaintiff was repeatedly solicited to make additional purchases. He declined to do so. It seems apparent that, by asking for cancellation of the challenged stock purchases, plaintiffs seek a windfall to the extent that the corporation has received value for its treasury stock. In realization of this, plaintiffs have retreated from their position. In any event, the failure to plead this alleged fraud or to seek to amend the pleadings to conform to the proof, as suggested by defendants, is also fatal to plaintiffs' demand for cancellation.

14. As reflected in an earlier ruling, there is no basis for an award of punitive damages for violation of either §10(b) or §5. Hill York Corp. v. American International Franchises, Inc., 448 F.2d 680, 697 (5th Cir. 1971); Green v. Wolf Corp., 406 F.2d 291, 303 (2d Cir. 1968); de Haas v. Empire Petroleum Co., 435 F.2d 1223, 1231 (10th Cir. 1970). Nothing presented at trial justifies an award of punitive damages on the state law claims.

15. Plaintiffs' requests for attorneys' fees, for an accounting, and for appointment of a receiver are denied. Other relief sought, (except as hereinabove granted) likewise is denied. In each instance where denied, plaintiffs failed to establish a basis for such relief.

16. The order requiring posting of security by plaintiffs, entered March 6, 1972, is vacated, and the Clerk of the Court is directed to return the securities posted pursuant to that order to plaintiffs or to Heiman & Crary, as attorneys for plaintiffs.

17. Plaintiffs shall submit a form of judgment with a copy to defense counsel within seven (7) days from the entry of this order. Defendants may file objections as to form within three days thereafter.

THIS 27th day of March, 1972.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

ELECTION

Filed March 29, 1972

Plaintiffs, J. WILLIAM WOLF and PEARL M. WOLF, pursuant to the instructions and authority contained in ¶5, Page 9, of the Findings of Fact and Conclusions of Law, entered March 27, 1972, elect not to tender the shares of stock in INDUSTRIAL-GUARANTY BANCORP, owned by said Plaintiffs.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

FINAL JUDGMENT

Filed April 5, 1972

The Court having entered its Findings of Fact and Conclusions of Law on March 27, 1972, it is

ORDERED AND ADJUDGED as follows:

1. INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, do have of and recover from the Defendant, JACK H. STEIN, the sum of TWO HUNDRED FORTY EIGHT THOUSAND SEVENTY TWO AND 11/100 DOLLARS ($248,072.11), for which let execution issue.

2. INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, do have of and recover from the Defendant ROBERT R. FRANK, the sum of ONE HUNDRED THIRTY EIGHT THOUSAND NINE HUNDRED TWENTY ONE AND 64/100 DOLLARS ($138,921.64) for which let execution issue.

3. INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, do have of and recover from the Defendant, JOHN W. ROBERTS, JR., the sum of ONE HUNDRED NINE THOUSAND ONE HUNDRED FIFTY ONE AND 90/100 DOLLARS ($109,151.90), for which let execution issue.

4. In addition to the sums provided for in ¶¶1, 2 and 3 above, INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, do have of and recover from the Defendants, ROBERT R. FRANK, JACK H. STEIN and JOHN W. ROBERTS, JR., jointly and severally, the sum of SIXTY THOUSAND EIGHT HUNDRED SIXTY ONE AND 59/100 DOLLARS ($60,861.59), for which let execution issue.

5. Plaintiffs, J. WILLIAM WOLF and PEARL M. WOLF, individually and derivatively for the shareholders of INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, do have of and recover from the Defendants, ROBERT R. FRANK, JACK H. STEIN, JOHN W. ROBERTS, JR., individually and as purported trustees under a Voting Trust Agreement, dated June 2, 1969, relating to the issued shares of INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, and INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, the reasonable expenses and costs of maintaining this action to be hereafter taxed pursuant to the applicable rules of procedure.

6. Plaintiffs have filed in this Court through counsel of record their election not to tender the 14,000 shares of INDUSTRIAL-GUARANTY BANCORP. owned by them pursuant to the authority granted in the Findings of Fact and Conclusions of Law entered March 27, 1972.

7. The Court has previously reserved ruling on whether Plaintiffs are entitled to reasonable attorneys' fees. The Court finds that there is no legal basis for the award of such attorneys' fees, and the demand for reasonable attorneys' fees be and the same is hereby stricken.

8. HEIMAN AND CRARY, P.A., counsel of record for the Plaintiffs in this cause, is authorized to act as counsel on behalf of INDUSTRIAL-GUARANTY BANCORP., a Florida corporation, in connection with any post-trial motions, appellate proceedings, proceedings to enforce this judgment, and in any other matter in connection with this cause.

DONE AND ORDERED in Chambers at Miami, Dade County, Florida, this 4th day of March, 1972.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

[TITLE OMITTED]

ORDER ON DEFENDANTS' POST TRIAL MOTIONS

Filed April 19, 1972

This cause is before the Court on various post-trial motions filed by the defendants. Having considered the record and the memoranda submitted, it is ORDERED AND ADJUDGED as follows:

1. Defendants' motion for new trial is denied. While the NIB-IGB stock transaction was not expressly referred to in plaintiffs' complaint, paragraph 12.2 of the second amended complaint raises a broad challenge to the methods by which the defendants acquired their stock in IGB. The defendants were well aware at the pretrial stage that this challenge would be pursued at trial. Furthermore the Court, during trial, informed counsel for the defendants of its specific concern over the exchange ratio used in said transaction and asked the defendants to introduce evidence as to the valuation of the stocks involved. Defendants' other contentions are wholly without merit.

2. Defendants' motion to amend final judgment is denied.

3. Defendants' motion to amend findings of fact and conclusions of law is granted to the following extent:

a) The date of the first purchase in paragraphs 6 and 8 of the findings is amended to read "July 28, 1969" rather than "July 10, 1969".

b) The number of shares purchased in paragraph 20 of the findings is amended to read "260,000" rather than "250,000."

In all other respects, defendants' motion to amend is denied.

4. The order of this Court entered April 11, 1972 staying execution on the judgments in this cause shall expire ten (10) days from the entry of this order.

ENTERED at Miami, Florida this 19th day of April, 1972.

SUPREME COURT, U. S.
FILED
SEP 7 1973
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1973

CASE NO. 73-197

ROBERT R. FRANK, et al.,

Petitioners,

vs.

J. WILLIAM WOLF, et al.,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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MIAMI REVIEW — 371-4853 — 377-3721

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

The Petition for Writ of Certiorari filed by Petitioners bears no relation whatsoever to what transpired in the courts below. The only questions properly presented by this Petition and the record below are as follows:

I. WHETHER THE UNITED STATES SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER THE FINDINGS OF FACT OF A TRIAL COURT JUDGE WERE CLEARLY ERRONEOUS PURSUANT TO RULE 52(a), FEDERAL RULES OF CIVIL PROCEDURE.

II. WHETHER THE SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER A TRIAL COURT JUDGE HAS PROPERLY EXERCISED HIS EQUITABLE DISCRETION.

COUNTER-STATEMENT OF THE CASE

Petitioners' statement of the proceedings in the trial court bears no relation to what actually transpired. For this reason, Respondents will briefly recite the facts as found by the trial judge. In doing so, we will quote from the opinion in this cause of the United States Court of Appeals for the Fifth Circuit and make reference to the numerous and detailed findings of fact made by the District Court. These findings of fact are reproduced in their entirety in the Appendix filed by Petitioners with their Petition for Writ of Certiorari at (A. 64). Reference will be made where possible to each particular findings of fact as "F of F". For clarity, the parties are referred to in their capacity in the trial court:

"In early 1969, plaintiff J. William Wolf began discussing with defendants Robert R. Frank and Jack H. Stein the possibility of his investing in IGB, a Florida corporation with its principal place of business in Florida. (F of F2 and 3). Defendants Frank, Stein, and Roberts organized IGB with the intention of making it a bank holding company, and they served at all relevant times as officers and directors of IGB. (F of F2 and 4). Plaintiff repeatedly met with defendants, in various combinations, to discuss IGB. (F of F6). Prior to plaintiffs' initial purchase, defendants Stein and Frank represented to plaintiff that they were going to allow not more than fifteen of their friends to purchase shares in IGB before making a proposed public offering. They represented that everyone would pay $2.00 cash per share and that there would be no free stock or fringe benefits. (F of F7). In reliance upon these and other representations concerning (1) an application by IGB to the Federal Reserve Board for approval as a bank holding company, (2) the acquisition plans of IGB, and (3) the progress of registration of IGB shares with the Florida Securities Commission, plaintiffs purchased 37,500 shares of IGB stock for $75,000.00 between July 28, 1969 and October 8, 1969. No registration statement was then in effect as to those securities. (F of F8).

As early as July 24, 1969, prior to the initial purchase of IGB stock, plaintiff began inquiring among his friends about resales to them of the IGB stock that was to be purchased. During the six-month period beginning in late July, 1969,

plaintiffs sold at least 23,000 of their 37,500 shares to approximately fourteen persons in various parts of the United States at prices ranging from $2.00 to $5.00 per share. In these transactions plaintiffs realized a total of $95,000.00, some $20,000 more than they had paid for all their IGB stock. (F of F9).

In fact, an application for approval as a bank holding company was never filed on behalf of IGB. Furthermore, defendants did not pay $2.00 cash per share when they acquired their own stock interest in IGB. First, in September, 1969, defendants exchanged 19,826 shares of stock in the National Industrial Bank [hereinafter NIB] with IGB for 346,995 newly issued shares of IGB stock, pursuant to an exchange ratio computed by defendant Roberts. (F of F10). At the exchange value of $2.00 per share, the IGB stock acquired in the exchange by defendants was worth $693,910.00. The NIB stock that the corporation received from defendants in exchange was worth considerably less. It had been purchased by defendants in January, 1968 for $197,260.00, or $10.00 per share, and was selling for $10.00 per share in October, 1969. Second, on January 16, 1970, defendants received 184,935 shares of IGB stock in exchange for non-interest bearing, unsecured promissory notes in the amount of $369,870.00 due in 1973. (F of F10, 11 and 12).

A voting trust agreement reflects that defendants controlled 1,336,391 voting shares of IGB and were at all material times in control of the com-

pany. (F of F17). Although IGB's Certificate of Incorporation requires the directors to fix the value of any property received by the corporation in exchange of stock, this was not done in conjunction with the transfer by defendants of their 19,826 shares of their NIB stock for 346,995 shares of IGB stock [hereinafter the 'NIB-IGB stock exchange']. In that exchange, a ratio of 17½ to 1 was the basis used, and the value of the IGB stock was calculated at its par of $1.00 per share. Under this ratio, defendants received the equivalent of $17.50 per share for their NIB stock. If the transaction had been based on payment of $2.00 per share for the IGB stock, the sum that defendants had represented would be paid and that everyone else did in fact pay, then defendants actually received what amounted to $35.00 per share for their NIB stock, which was worth no more than $10.00 per share. The required valuation was also neglected in connection with the issuance of stock to defendants in exchange for their promissory notes. (F of F13).

At a directors meeting held on January 16, 1970, defendants, acting as directors, elected three additional directors. The new directors, with defendants abstaining, authorized defendants to purchase the aforementioned 184,935 shares of IGB stock by executing noninterest bearing, unsecured notes in the total amount of $369,870. (F of F22 and 23). At the same time that these noninterest bearing and unsecured notes of defendants were outstanding, IGB borrowed greater sums from banks at interest rates varying from 7½ percent

to 9½ percent per annum. Such loans were fully secured by part of the assets of IGB. (F of F18). The newly constituted board of directors, with defendants voting, 'ratified' the NIB-IGB stock exchange and all other actions taken on previous occasions by defendants as directors. (F of F23). No annual or special meeting of stockholders of which plaintiffs received notice was held until January 21, 1971. (F of F21).

Soon after the meeting of January 21, 1971, plaintiffs brought this action both individually and derivatively as stockholders of IGB against defendants. The complaint charged that: (1) misrepresentations, omissions, and acts of defendants constituted a manipulative and deceptive device and contrivance and a scheme and artifice to defraud in connection with the sale of securities of IGB to plaintiffs, all of which was in violation of Rule 10b-5; (2) sale by defendants to plaintiffs of the IGB stock constituted a violation of Section 5 of the Securities Act of 1933, 15 U.S.C. §77e, because no registration covering the securities had been declared effective by the United States Securities and Exchange Commission; (3) defendants committed common-law fraud in connection with plaintiffs' purchase of IGB stock.

Relying on Rekant v. Desser, 5 Cir. 1970, 425 F.2d 872, the District Court found that plaintiffs had established a derivative Rule 10b-5 violation by defendants in that defendants' activities in the NIB-IGB stock exchange constituted a fraudulent issuance of stock to insiders for grossly inade-

quate consideration. The District Court found that the NIB stock was worth $198,260.00 and that therefore defendants paid approximately $.57 per share of IGB stock issued to them, or $1.43 less than the $2.00 per share that defendants represented that they would pay for their IGB purchase. The Court ordered defendants to reimburse IGB $1.43 per share of IGB received in the fraudulent transaction. The District Court also found, however, that plaintiffs were not entitled to individual relief under Rule 10b-5 because they failed to show any actual individual damages in connection with the sale or purchase of IGB stock, since through their own sales of IGB stock they had made a profit of approximately $20,000.00 in addition to the value of the IGB shares they retained.

The District Court relied on Hill York v. American International Franchises, Inc., 5 Cir. 1971, 448 F.2d 680, in finding that defendants had violated Section 5 of the Securities Act of 1933 and in granting the individual plaintiffs the option of rescinding their purchase of 14,000 shares of IGB stock. The Court also held that Section 5 of the 1933 Act did not authorize derivative relief for the corporate entity.

Finally, the District Court found that defendants breached their fiduciary duty on January 16, 1970 by paying for IGB stock with non-interest bearing notes. The Court ordered defendants to pay IGB 7½ percent back-interest on the $369,870.00 note, from January 16, 1970 to the date of the judgment." (A. 3 to A. 8).

POINT I

WHETHER THE UNITED STATES SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER THE FINDINGS OF FACT OF A TRIAL COURT JUDGE WERE CLEARLY ERRONEOUS PURSUANT TO RULE 52(a), FEDERAL RULES OF CIVIL PROCEDURE.

The trial court correctly concluded that the defendants had looted IGB by causing it to fraudulently issue stock to them for a grossly inadequate consideration in connection with the exchange by defendants of 19,826 shares of NIB for 346,955 shares of IGB. The trial court had before it uncontradicted documentary evidence that defendants paid only $10.00 per share or $198,260.00 for the NIB stock for which they received, based on the $2.00 per share that everyone else was paying, $693,910.00 worth of IGB stock. Plaintiffs offered Exhibit 146 at trial which demonstrated that on October of 1969, one month after the exchange, NIB stock was still selling at only $10.00 per share. Based on this evidence, defendants paid only $.57 per share for their IGB stock based on the 17½ to 1 exchange ratio used. To put it another way, although the market value of NIB stock at the time of the exchange was shown to be $10.00 per share, defendants received $35.00 per share for the NIB stock. As the trial judge correctly stated in his findings of fact:

> "Under any measure of value, the NIB stock was greatly overvalued in exchange." (A. 67).

In addition, there was uncontroverted documentary evidence introduced at trial that while the defendants had obtained stock in IGB in return for noninterest bearing unsecured promissory notes, IGB was borrowing from banks greater sums at interest rates varying from 7½ percent to 9½ percent per annum. This was firmly established by the books and records of IGB as well as the notes executed by the defendants. Moreover, the defendants admitted that they obtained the shares of IGB for these noninterest bearing unsecured promissory notes.

In view of the foregoing, it is obvious that the trial judge correctly decided that the defendants had defrauded the company and this Court should clearly not exercise its discretion to determine whether the findings of fact of the trial court judge were clearly erroneous. Not only were they not clearly erroneous, they were the only conclusion that any trier of fact could reach under the circumstances of this case.

POINT II

WHETHER THE SUPREME COURT SHOULD EXERCISE ITS DISCRETION BY GRANTING A PETITION FOR WRIT OF CERTIORARI TO DETERMINE WHETHER A TRIAL COURT JUDGE HAS PROPERLY EXERCISED HIS EQUITABLE DISCRETION.

The case was tried over a period of six days by an experienced trial judge who had previously presided at many sophisticated securities cases. Based on all the facts introduced at trial, it is clear that the trial court properly concluded that the plaintiffs were not barred from recov-

ery by the equitable doctrine of unclean hands. The applicable law was correctly stated by the Fifth Circuit in its opinion below:

> "While the defense of 'unclean hands' is available in securities actions in this Circuit, Kuehnert v. Texstar Corp., 5 Cir. 1969, 412 F.2d 700, its application rests within the sound discretion of the District Court. Whether the defense is allowed should be determined by ascertaining whether the application or non-application of the defense will better promote the objectives of the securities laws by increasing the protection afforded the investing public. Id. The District Court did not abuse its discretion in refusing to bar plaintiffs from maintaining a suit to enforce the requirements of Section 5 of the Securities Act of 1933." (A. 11 to A. 12).

Further, as the Fifth Circuit also pointed out in its opinion:

> "Defendants are purblind to the fact that this is not a case of a brigand seeking to recover his loot. Plaintiffs' actions, alleged to be illegal were in no way involved with the transactions for which the District Court granted derivative relief. Furthermore, although defendants contend that plaintiffs are economic pirates disqualified because of their piracy from representing an innocent corporation, the District Court made no such finding and in fact found that only defendants were picaroons." (A. 15).

The barring of the plaintiffs' recovery, either individually or derivatively, in the case at bar would in no way promote the objectives of the securities laws by increasing the protection afforded to the investing public. All it would accomplish, and all the defendants seek to accomplish, would be to allow the defendants to escape unscathed with their ill-gotten gains. The plaintiffs alleged unclean hands by virtue of resales of stock do not alter the fact that the corporation was defrauded by the defendants in connection with the NIB-IGB exchange and the purchase of stock for notes, or that the defendants violated Section 5 of the Securities Act of 1933 when they sold plaintiffs their IGB stock. Moreover, the plaintiff resales do not even have any bearing at all upon these wrongs and should not prevent their being redressed.

Accordingly, this Court should not grant a Writ of Certiorari to determine whether the trial judge properly exercised his equitable discretion in refusing to apply the defenses of unclean hands and in pari delicto in this particular case. It is apparent that the trial judge's findings in this regard were correct.

We will now deal with each of the purported questions presented in the Petitioners' Brief for the convenience of the Court despite the fact that these questions are not properly presented by this record. Each question will be numbered as it was in the Petitioners' Brief.

I. The Court below did not find nor was it compelled to find that defendant was a "market making dealer who was an insider tipster/tippee." However, even if this was so, the only persons with standing to complain about this would be those who purchased from the plaintiff and not

these defendants. See **Affiliated Ute Citizens v. U.S.**, 408 U.S. 128 (1972). Since plaintiffs did not sell stock to these defendants and had no duty of disclosure to them, this point has no merit.

II. This was an action under the Securities Act of 1933 and the Securities Exchange Act of 1934, both of which are Federal Statutes. Accordingly, no diversity of citizenship had to exist for Federal jurisdiction. However, it should be noted that the trial judge found as a fact that diversity of citizenship did exist. (A. 65). With respect to the amount in controversy, a judgment in the amount of $557,613.56 was entered. No more need be said about this purported question.

III. Relief in this case was not granted under "Federal Corporation Law" but was granted for violations of Section 10b of the Securities Act of 1934 and Rule 10b-5 thereunder. See **Rekant v. Desser,** 425 F.2d 872 (5th Cir. 1970).

IV. Unclean hands and in pari delicto were pled by the defendants. (A. 50 to A. 51). The trial court found as a matter of fact that there was no basis for applying unclean hands or in pari delicto. The United States Court of Appeals for the Fifth Circuit directly considered this question and found it to have been resolved properly below. (A. 10 to A. 12).

V. The plaintiffs pled and proved that they fairly and adequately represented the interest of the other shareholders of IGB. (A. 45). After all, the Court entered a judgment for $557,613.56 in favor of IGB and against the defendants which will inure to the benefit of all the share-

holders of IGB. Under the circumstances, it is laughable for the Petitioner to assert that the plaintiffs did not fairly and adequately represent the interest of the other shareholders of IGB, when this fund has been created for their benefit. It should also be noted that in the trial court defendants moved for a dismissal on these grounds and the court found as a matter of fact and law that the plaintiffs did fairly and adequately represent the other shareholders and the court summarily denied this motion by the defendants.

VI. The District Court did not grant relief beyond the supposed limitations contained in either the Securities Act of 1933 or the Securities Exchange Act of 1934. Contrary to the position of the Petitioners, the District Court did not make the plaintiffs more than whole but rather granted relief to the corporation in a derivative lawsuit brought on behalf of the corporation by the plaintiffs. This recovery was clearly in accordance with the pronouncements of this Court and the Fifth Circuit. See **Superintendent of Insurance v. Bankers Life & Casualty Company,** 404 U.S. 6 (1971); **Rekant v. Desser,** supra.

VII. Petitioners' question here was properly resolved by the United States Court of Appeals for the Fifth Circuit. In addition, it should be noted that the defendants did not plead the statute of limitations as a defense to the 10b-5 actions below. (A. 51). The statute of limitations does not affect subject matter jurisdiction. It does not affect the ability of the court to hear a case, and, accordingly, the failure of defendants to plead the defense below constitutes a waiver of this defense. **Headrick v. Atchison, T & S Ry. Co.,** 180 F.2d 305 (10th Cir. 1950). The Fifth

Circuit's treatment of this argument by the Petitioners is as follows and no further comment is necessary:

> "Defendants nevertheless contend that even though plaintiffs filed this action within the two-year statute of limitations, which defendants argue is applicable under F.S.A. §517.21, plaintiffs are barred because they failed to tender their securities to defendants as required by F.S.A. §517.21. Plaintiffs reply that Florida's three-year statute of limitations for actions brought for relief on the ground of fraud, F.S.A. §95.11, is applicable and that they fall well within that time period.
>
> Defendants' argument misconceives the issue. This suit was maintained in the District Court under Rule 10b-5, not under pendent jurisdiction of a state claim. When applying the forum's statute of limitations to actions brought under the federal securities laws, federal courts borrow only the chronometric aspects and not the procedural or substantive nuances of the law of the forum. We therefore find it unnecessary to determine whether the applicable statute of limitations is the two-year limitation embodied in Section 517.21 or the three-year limitation of Section 95.11 because plaintiffs commenced this action well within either period of limitation. (A. 13).

VIII. Whether the Petitioners' statement of the clearly erroneous rule or the Fifth Circuit's statement of the clearly erroneous rule is adopted, the result is the same. The trial court properly decided all questions of fact below.

The United States Court of Appeals for the Fifth Circuit ruled on these matters within the limits of its scope of review and also decided them properly. Accordingly, there is no need for this Court to take jurisdiction of this matter and the Petition for Writ of Certiorari filed by the Petitioners must be denied.

CONCLUSION

The Petition for Writ of Certiorari does not present any question which should be heard by this Honorable Court. Accordingly, the Petition should be denied.

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CERTIFICATE OF SERVICE

WE HEREBY CERTIFY that a true and correct copy of the foregoing Respondents' Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit was served by mail upon Irving M. Wolff, Esq., Attorney for Petitioners, 916 Biscayne Building, Miami, Florida, 33130, this ____ day of September, 1973.

Of Counsel

SUPREME COURT, U. S.

FILED
NOV 16 1973
MICHAEL RODAK, JR., CLERK

in the

Supreme Court of the United States

October Term 1972

NO. 73-197

ROBERT R. FRANK, et al.,

Petitioners,

vs.

J. WILLIAM WOLF, et al.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

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MIAMI REVIEW — 371-4853 — 377-3721

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in the

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October Term 1972

NO. 73-197

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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PETITION FOR REHEARING

Petitioners present their petition for a rehearing of this Court's order dated October 23, 1973, denying the petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit, and in support thereof respectfully show:

GROUNDS FOR REHEARING

The following intervening circumstances of substantial or controlling effect have transpired which would support this Court's consideration to grant rehearing and vacate the order heretofore entered denying the issuance of its writ of certiorari to the United States Court of Appeals for the Fifth Circuit.

As further grounds for this Petition, Petitioner respectfully will direct the Court's consideration to substantial grounds.

A. Intervening Circumstances of Substantial or Controlling Effect Which Have Transpired.

I.

This Honorable Court has heard argument in **Zahn v. International Paper Company,** Case No. 72-888, opinion below 469 F.2d 1033 (CA2 1972). The issues in *Zahn* deal with substantial questions involving the application of jurisdiction of United States District Courts. *Zahn*, if affirmed and held to be in accordance with **Snyder v. Harris,** 394 U.S. 332 (1969), will create a direct conflict, involving proper application of jurisdiction by the federal courts, with **Wolf v. Frank.**[1]

The question in *Zahn, supra,* in connection with accumulation of claims in order to establish jurisdictional amount in a diversity suit, is present in the instant matter. A federal court lacking jurisdiction in the first instance cannot dispose of issues arising under state law, since ancillary or pendent jurisdiction cannot be invoked.

[1]477 F.2d 467 (CA5 1973).

II.

The decision below stands in direct conflict with **Zeller v. Bogue Electric Manufacturing Corporation**, 476 F.2d 795 (CA2 1973), certiorari denied October 16, 1973, Case No. 72-1616 [42 LW 3215, 3226]. The Zeller decision sets forth a requisite degree of proof necessary to be discharged by the plaintiff in Securities Exchange Act litigation.

The degree of proof required below and approved by the decision of the United States Court of Appeals for the Fifth Circuit is in direct conflict with *Zeller, supra.*

III.

In a third decision now under review by this Court, **Landry v. Hemphill, Noyes & Co.**,[2] Case No. 73-276, we find the effect of a violation of Regulation T of the Federal Reserve Board upon the ability of a party to recover.

The indication of this opinion in Landry, supra, as well as **Pearlstein v. Scudder & German**, 429 F.2d 1136 (CA2 1970), seems to indicate a trend is being developed in the United States Courts of Appeals for the First and Second Circuits, which can deny recovery to plaintiffs seeking relief under the Securities Exchange Act of 1934 and Rule 10b-5, where said parties have voluntarily violated the provisions of Regulation T of the Federal Reserve Board. Such violations would effectively void the entire transaction on a basis detrimental to the wrongdoer.

---

[2]Decision below, 473 F.2d 365 (CA 1 1973); petition for certiorari filed August 10, 1973 and not acted upon by this Court.

Thus, the opinion below raises the question, can a wrongdoer—one in violation of Regulation T, where the violation has been of his own volition—be afforded a status of litigant to institute a proper class action? If the violation affects the legality of his stockholder status, such a person is not a proper party.

B. Substantial Grounds.

I.

The United States Court of Appeals for the Sixth Circuit has applied the provisions of Rule 23.1,[1] as a matter of law, to preclude a party, whose interests are at a variance with and are antagonistic to those of shareholders or parties entitled to hold stock, from maintaining a derivative suit, since such party cannot fairly, impartially and adequately represent the group in the derivative action. **Nolen v. Shaw-Walker Co.**, 449 F.2d 506, 508 (CA6 1971).

This Honorable Court's denial of the application for the writ of certiorari has not given proper weight to the conflict which the decision has created with *Nolen, supra.* The decision below sanctions a nonregistered dealer and market maker, who has exploited a class of stockholders by his manipulative and deceptive practices upon them, to represent such group in a derivative action.

This Court has not, nor has any Circuit Court of Appeals of the United States, rendered any opinion or

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[1]Rules of Civil Procedure, 28 U.S.C.A.

decision establishing limitations in connection with the application and interpretation of the provisions of this instant rule. It would, therefore, appear that this Honorable Court in the exercise of its supervisory jurisdiction, should take the steps necessary to proscriptively limit the application of federal equity jurisdiction where a cause of action has been instituted by parties who are themselves in violation of the provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, Rule 10b-5 and Regulation T of the Federal Reserve Board.

II.

The foregoing problem directly affects the applicability of *pari delicto*—"unclean hands"—defenses and their availability in Securities Exchange Act of 1934 and Rule 10b-5 litigation.

The opinion below maintains that the allowability of such a defense is a discretionary right with the trial court, but it fails to recognize that the Acts of Congress do not grant any discretionary rights per se to the judiciary in connection therewith. Therefore, basic guidelines limiting and utilizing the discretionary right of the trial courts must be established.

Finally, this Honorable Court must at some time make a determination to either limit or extend the principle which it has applied in anti-trust and Securities Act of 1933 litigation, specifically, a *pari delicto* defense will not be permitted under any circumstances, to Securities Exchange Act of 1934 and Rule 10b-5 matters.

Thus, if it was the Congressional intent to prohibit such defenses, there should be a voicing of the clear prohibition. If, on the other hand, such defenses remain discretionary with the trial courts, there should be an enunciation of well-defined areas guiding the trial courts in connection with utilization of their discretion in allowing or disallowing the defense. Until the problem is resolved, the federal judiciary is prone to the voicing of many conflicting theories, to further confuse a situation overburdened by conflict and confusion.

CONCLUSION

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that, upon further consideration, writ of certiorari issue to the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

IRVING MARK WOLFF, P.A.
and FRANK, STRELKOW & GAY
Attorneys for Petitioners

By IRVING M. WOLFF
IRVING M. WOLFF

CERTIFICATE OF GOOD FAITH

I, IRVING M. WOLFF, counsel for the above named Petitioners, do hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay, and that it is restricted to the grounds specified in Rule 58, subdivision 2, of the Rules of this Court.

IRVING M. WOLFF
IRVING M. WOLFF

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Petition for Rehearing was this 14th day of November, 1973 mailed to HEIMAN and CRARY, Attorneys for Respondents, 1428 Brickell Avenue, Miami, Florida 33131.

IRVING M. WOLFF

IRVING M. WOLFF